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# MONOGRAPH NO. 23
# CONSUMER BANKRUPTCY STUDY
# VOLUME 1
## Consumers' Right to Bankruptcy
## Origins and Effects

1982

Krannert Graduate School of Management – Purdue University

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# CONSUMER BANKRUPTCY STUDY

## VOLUME I

## Consumers' Right to Bankruptcy: Origins and Effects

CREDIT RESEARCH CENTER
in cooperation with
ARTHUR D. LITTLE, INC.
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1982

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# PREFACE

This study had been prepared by the staff of the Credit Research Center (CRC) in cooperation with Arthur D. Little, Inc. (ADL) and Opinion Research Corporation (ORC). The study was financed by the Coalition for Bankruptcy Reform, a group made up of a broad cross section of the consumer credit industry and associated organizations. About five-sixths of the funding was used to cover the costs of the field survey of consumers filing for Chapter 7 in 20 judicial districts in ten states. The remaining one-sixth was provided to CRC to help defray the incremental costs of preparing the study. The Credit Research Center is within the Krannert Graduate School of Management, Purdue University.

When a study is funded by an industry group, one must be prepared to hear charges of bias "in favor of" the industry. Such charges are, of course, based on a false premise that what is good for the industry is bad for consumers and vice versa. As we have shown in this and a number of earlier research studies, issues of public policy in the areas of consumer and mortgage credit involve trade-offs--more accurately, subsidies or wealth transfers--between one group of consumers and another. In this competitive market, one could not bias a study "in favor of" the credit industry _per se_, even if that were the objective.

Nonetheless, the research was structured in a manner to avoid potential bias, or the taint of bias. The questionnaire to be administered to debtors was prepared by three members of the CRC staff: Robert W. Johnson, Richard L. Peterson, and A. Charlene Sullivan. That and subsequent drafts were modified on the basis of suggestions from Dr. Edwin B. Cox and Blair C. Shick of ADL and Sandra M. Spies of ORC. Nobody from the credit industry or associated organizations saw the questionnaire until after it was in the field.

Edwin Cox and Blair Shick of ADL had prime responsibility for designing the sampling plan, both in the selection of the states and judicial districts and in the procedures to follow in selecting consumers to be interviewed. They also had the task of gaining the cooperation of the judges in each of the districts and that of the attorneys appearing in the courts. CRC staff had no contact with any of the many judges who cooperated in this research effort.

The interviewing of the debtors and the gathering of data from the petition was the sole responsibility of the staff of ORC. The important functions of coding and tabulating the data were entirely the duty of ORC staff. The raw data in the form of the questionnaires and petition data forms remain in Princeton with ORC, both to separate the data gathering and data analysis functions and to protect the privacy of the consumers interviewed.

The analysis of the data was the responsibility of the staff of CRC. ORC provided us with a computer tape encoded with the data on the 1,199 cases sampled. With the aid of able graduate research assistants (Swaminathan G. Badrinath and Dan A. Black) we prepared the tables provided in this and the following monograph, as well as many supplementary tables used in the analysis of the data. Members of the credit industry had no part in this analysis, nor did any of the CRC staff have a role in drafting or reviewing the proposed amendments to the Bankruptcy Act of 1978 proposed by the Coalition.

This study does not relate to changes in bankruptcy legislation introduced by the Bankruptcy Act of 1978. Instead, this study provides an empirical investigation and analysis of a public policy established in 1898 under the Bankruptcy Act passed in that year. At that time Congress decided that consumers could file for bankruptcy without regard to their ability to pay some portion of their debts out of future income. That policy has remained essentially unchanged since that time. Whether that is a sound policy in the very different credit markets of 1982 is a value judgment. The empirical data and analysis provided in this monograph provide a basis of reaching that value judgment.

We are greatly indebted for the highly professional and constructive contributions of Ed Cox and Blair Shick at ADL and Sandy Spies and Carole Hewitson of ORC. Not only are they experts at what they do, but they are delightful to work with. We also thank our secretarial staff--Marty Lynch, Cindy Overman and Betty Schoenhals for their skills and patience. Finally we thank each other for carefully reviewing and editing the numerous drafts of each of the chapters.

Robert W. Johnson
Richard L. Peterson
A. Charlene Sullivan

# CHAPTER 1

## BACKGROUND OF STUDY

Robert W. Johnson

This research addresses the public policy reflected in federal bankruptcy legislation that enables debtors to file for bankruptcy, regardless of their ability to repay their debts out of expected future income. This policy is not new. The privilege has been provided in federal legislation since 1898.

In the first section of this chapter the origins of bankruptcy are traced, including a brief legislative history of bankruptcy legislation in the United States. To illustrate an alernative legislative regimen, a current proposal to modify the policy regarding consumers' access to bankruptcy is cited in the next section. The third section reviews previous research concerning the policy and identifies the unique contributions provided by this study. The final section sets forth the key questions that must be addressed by empirical research to form a judgment regarding the desirability of a standard of admission to consumer bankruptcy.

### I. Origins of Bankruptcy Legislation

### A. Ancient Origins

Summerian documents dating from about 3000 B.C. reveal a use of credit based on grain and silver. The customs of the time were incorporated in the Code of Hammurabi (about 1800 B.C.). Interest on loans of grain and silver was limited, and all loan contracts had to be prepared and witnessed in the presence of an official. Credit was extended on the basis of property, real or personal--"wife, concubine, children, slaves, land, houses, utensils, credits, the door. But servitude for debt could not last more than three years. Later this time limit was extended." In addition, "Provision was made for court settlement if there were several unsatisfied creditors."[1]

Not only did ancient commercial custom allow for asset-based financing and court-supervised distribution of assets to creditors, but provision was also made for periodic discharge of debts, as noted in the study on usury being undertaken by John Houkes:[2]

> During the Old Babylonian period it was customary for the king to proclaim a general amnesty or act of "equity," in the Accadian language misharum, at the beginning of his reign and at intervals of seven years thereafter. This act resulted in the remission of debts and the return of pledged land to the original owners.
>
> The Edict of Ammisaduqu proclaimed about 1650 B.C. represents an example of such an act . . .
>
> 4: Whoever has given barley or silver to an Akkadian or an Amorite as an interest-bearing loan, or on the melqetum basis...and had a document executed--because the king has invoked the misharum for the land, his document is voided; ... he may not collect the barley or silver on the basis of his document.

Obviously, these debts were eliminated without considering the debtors' ability to repay them. It seems doubtful that much credit was granted in the period immediately preceding a misharum.

As an interesting aside, the Bankruptcy Act of 1978 permits the trustee to void certain transfers that occurred prior to filing for bankruptcy. Thus, payments received by a creditor during the 90 days prior to bankrutpcy are probably recoverable by the trustee for the estate [Section 547(b)(4)]. The Edict of Ammisaduqu dealt directly with the same issue: "He who does not make a refund of collections previously received in accordance with the royal decree shall die."[3]

Bankruptcy proceedings were designed for the benefit of creditors, rather than debtors. In essence, their purpose was to provide an orderly alternative to collection efforts by individual creditors. A debtor's assets were to be marshalled for joint and equitable distribution to creditors.

The derivations of the word "bankruptcy" evidence this principle. The term comes for Old Italian banca (bank, akin to the Old English benc, or bench) and rotta (broken). The latter word is derived from the Latin, rupta, feminine of ruptus, past participle of rumpere, to break.[4] The words "broken bench" relate to Roman law, under which creditors gathered the assets of a debtor and, following their distribution, broke his workbench or display table. The points to emphasize are that credit was business credit granted to merchants and craftsmen and that it was based on a debtor's assets, not future income. Once a debtor's merchandise or tools of trade were distributed to creditors and his workbench broken, there could be no expectation of future income.

Not only were bankruptcy proceedings designed for creditors, but debtors were regarded "... as defrauders and criminals. They were subjected to severe social and professional sanctions, including even a degrading form of dress."[5] Under ancient Roman law bankrupts were deprived of their civil rights. "In recent times, however, great efforts have been made to remove the disgrace attached to bankruptcy."[6] Thus, under The Bankruptcy Reform Act of 1978, consumers filing for Chapter 7 are called "debtors," not "bankrupts."

Because a debtor was usually a trader or merchant with his debts secured by assets, he typically had little incentive to seek bankruptcy. The proceedings would terminate the business and disgrace him personally. Thus, bankruptcy laws generally provided for the action to be brought by creditors. "Voluntary proceedings were not provided in England until 1844 and not in the United States until 1841."[7]

Finally, until fairly recent times, debtors were not granted a discharge of their unpaid debts following a bankruptcy proceeding. Under the English law (1542) bankrupts were regarded as criminals until they repaid all of their debts. It was not until 1705 that this position was softened, although very likely with the intent of benefiting creditors. If the debtor's liabilities were never discharged, he had every incentive to hide his assets. Discharge of debts was designed as a creditors' remedy to induce the debtor to reveal his assets in return for a final discharge of his obligations. As part of that process, he was also given a fresh start. In contrast to the laws of England, Commonwealth countries, and the United States, most countries in Europe and Latin America do not provide for the discharge of the unpaid portion of debts incurred prior to bankruptcy.

In summary, historical precedents had four key characteristics that influenced the development of bankruptcy legislation in the United States:

(1) Bankruptcy legislation was designed to protect creditors from each other and from debtors. It was a creditors' remedy, and creditors typically brought legal action to force a debtor into bankruptcy.

(2) The legislation was primarily for business debtors, since little consumer credit existed when the principles of law governing bankruptcy were developed.

(3) The legislation was based on a recognition that most debts would be secured by assets.

(4) For this last reason and because a failed business had no continuing life and income, no provision was made for payment of debts out of future income. Unpaid debts were not dischargeable until fairly recently, and even now principally in countries with legislation based on English law.

## B. Bankruptcy Legislation in the United States

The first American Bankruptcy Act was passed in 1800, although it was repealed just three years later.[8] Consistent with its heritage, it applied only to insolvent traders, merchants and brokers and made no provision for voluntary bankruptcy. A second bankruptcy act lasted only from 1841 to 1843, and a third prevailed between 1867 and 1878. The short duration of these laws evidently stemmed from the difficulty of travelling to the court, the dislike of federal intrusion into private affairs, and the administrative expenses involved.

Following an extensive depression, Congress enacted the Bankruptcy Act of 1898. Contrary to the heritage of creditor-oriented legislation from England and ancient Rome, the 1898 legislation had five consumer-oriented features:[9]

(1) the availability of voluntary relief without regard to the nature and extent of the bankrupt's indebtedness,

(2) the allowability of property exemptions,

(3) the general availability of discharge,

(4) the limited exceptions to discharge, and

(5) exemption of bankrupts from civil process to collect dischargeable debts.

The Bankruptcy Act of 1898 was periodically amended over the years, with the most extensive adjustment being the Chandler Act in 1938. That amendment added Chapter XIII, a plan whereby a wage earner could arrange to repay all or some portion of his or her debts out of future income under the protection of the court.

The first sweeping change in the 1898 Act began in 1970, when Congress established the Commission on the Bankruptcy Laws of the United States to "study, analyze, evaluate, and recommend changes" in the Bankruptcy Act. After extensive hearings and analysis, the Commission published its report in 1973.[10] Following additional Congressional hearings, Congressional members Don Edwards and M. Caldwell Butler introduced H.R. 6 in the 95th Congress. After amendments, it was subsequently passed as H.R. 8200 and signed by President Carter on November 6, 1978, with an effective date for most sections as of October 1, 1979.

The Bankruptcy Code of 1978 offers troubled consumer debtors two basic choices in addition to seeking relief directly from creditors.

On the one hand, any debtor may file with a U.S. Bankruptcy Court a petition for bankruptcy relief under Chapter 7 of the Bankruptcy Act. As was true under the previous statute, there is no requirement that the debtor be having difficulty in paying his or her creditors, that liabilities exceed assets, or--important to this study--that expected future income be insufficient to repay a reasonable portion of existing obligations. As provided by the Bankruptcy Reform Act of 1978:

> Section 301. Voluntary cases
>
> A voluntary case under a chapter of this title is commenced by the filing with the bankruptcy court of a petition under such chapter by an entity that may be a debtor under such chapter. The commencement of a voluntary case under a chapter of this title constitutes an order for relief under such chapter.

Along with the petition, the debtor must file a list of his or her debts and creditors and a list of all property owned, including that which will be claimed as exempt under state law. On the date of filing the debtor is automatically in bankrutpcy, and creditors must immediately cease collection or foreclosure activities. Following a meeting of the creditors, at which they may question the debtor, the trustee takes possession of any nonexempt property, sells it, and (after deducting administrative costs) distributes the available funds to creditors. If there are no objections, the bankruptcy judge will then grant the debtor a discharge, relieving him or her of liability for the payment of most prepetition claims. The trustee may either sell the pledged property to pay off a mortgage or lien if the debtor has nonexempt equity in the property or abandon the property so that the secured creditor may claim it or work out arrangements with the debtor to continue to make payments. In practice, the debtor under Chapter 7 is usually relieved of all or most of the unsecured debts.

On the other hand, a debtor with regular income from such sources as wages, salary, or commissions may select Chapter 13. Filing of a petition for Chapter 13 triggers many of the same events as in the case of Chapter 7: an automatic stay of collection activities, a first meeting of creditors, and appointment of a trustee. Not only are creditors forbidden from trying to collect from the debtor, but they are also barred from any efforts to collect any consumer debts from any cosigners. The debtor must file a plan for the partial or complete repayment of debtors, typically over a period of three years. A plan is confirmed if the court finds that it has been proposed in good faith, that the amount to be distributed to creditors is not less than they would have paid under Chapter 7, and that the debtor will be able to make the payments contemplated by the plan. Plans have been approved providing for payments to creditors via the trustee ranging from one percent to 100 percent of unsecured debts. A number of debts that would not be discharged under Chapter 7 may be discharged under Chapter 13, such as "debts obtained through false financial statements, debts for fraud or larceny, governmental fines or penalties, and student loans."[11] A further important advantage of Chapter 13 "is for the debtor who has some nonexempt property because he doesn't have to surrender it in the Chapter 13 proceeding."[12]

The debtor may at any time withdraw from the Chapter 13 arrangement or convert to Chapter 7. The court may also modify the plan after confirmation. Should the debtor fail to make payments to the trustee as agreed, the trustee may seek to remove the debtor from the protection of Chapter 13 or seek a modification of the plan. If the debtor completes the payments under the Chapter 13 plan, he or she is discharged.

## II. The Public Policy of Admitting Consumers to Bankruptcy

As indicated in the previous section, the policy of admitting consumers to Chapter 7, even though they had adequate expected income to repay their debts, was not an innovation of the Bankruptcy Reform Act of 1978. Voluntary relief and the general availability of discharge were features of the Bankruptcy Act of 1898.

Proposals to modify the policy established in 1898 regarding consumers' admission to bankruptcy debts have been introduced in the 97th Congress: S.2000 sponsored by Senators Dole, Heflin, Thurmond, Bauccus, Simpson, East, and DeConcini; and H.R. 4786 sponsored by Congressman Billy Lee Evans and over 200 other Representatives. Illustration of the key change in public policy addressed in this study is provided by S.2000:

> Sec. 2. Section 109 of title 11, United States Code is amended--
>
> "(c)(1) Subject to the provisions of paragraph (2) of this subsection, an individual may not be a debtor under chapter 7 of this title if such individual can pay a reasonable portion of his debts out of anticipated future income. For the purpose of this paragraph, the term--
>
> "(a) 'reasonable portion of debts' shall mean a substantial percentage of the total outstanding debt reflected upon the schedule of liabilities filed pursuant to section 521(1), excluding debts secured by a first mortgage or deed of trust on the debtor's principal residence:

> "(b) 'anticipated future income' shall mean such income, if any, that the debtor has a reasonable expectation of receiving, either from sources which--
>
> "(i) are providing actual income at the time of the filing of the petition, or
>
> "(ii) will provide income commencing upon a date certain within twelve months following the filing of the petitions,
>
> and which is not needed by the debtor for the support of himself and his dependents.
>
> "(2) The provisions of this section shall not apply in any case where the court finds that its application would impose undue hardship upon the debtor and the debtor's dependents."

## III. Previous Research

Very few studies have addressed the issue of bankrupt debtors' ability to repay debts from future income. The most comprehensive prior research was by Robert Dolphin, who obtained data from a questionnaire administered to 172 individuals filing for bankruptcy in 1963 in the U.S. District Court, Eastern District of Michigan.[13] To estimate their ability to repay debts from future income, he calculated two levels of income: adequate income and comfortable income. The first level was based on data developed by Robert Lampman for the Joint Economic Committee of Congress, and the second was based on Dolphin's experience as a resident of Flint, Michigan, where the court was located. Dolphin notes that "the Lampman figures are very similar to those used as a guide by Referee Bobier in the Flint court in considering an individual's ability to pay his debts under a Chapter XIII proceeding."[14]

Dolphin also adjusted for the size of family in developing his estimates of basic living expenses. For a family of four, he considered an adequate after-tax income in 1963 to be $2,763 and a comfortable after-tax income to be $3,600. (These data cannot be compared effectively with the data shown in Chapter 3 of this study because of the differences in tax adjustments and the elaborate calculation of basic living expenses in this study.)

On the basis of his calculations, Dolphin concluded[15]

> ---that 49 percent of the bankrupts from Genesee County during 1963 could have paid all of their debt within three years or less using the Chapter XIII proceedings and retained enough of their earnings to have an "adequate" standard of living... Using the writer's higher level of after tax income (the "comfortable" income), 28 percent of the bankrupts could have paid.

In a somewhat similar study based on 300 debtors' petitions during 1961-1964, Brosky concluded that[16]

> ...approximately one-fourth of the bankrupts would be strong prospects for a Chapter XIII or other out-of-court plan while another 40% of the bankrupts would perhaps bear further investigation toward determining the feasibility of a similar non-straight-bankruptcy plan.

Studies by Misbach and Reed reached very similar conclusions. In his study of Utah debtors, Misbach contended that 25 percent to 50 percent of the bankrupts could have repaid their debts from future income.[17] Reed concluded that one-fourth of debtors' income could be applied to future debts, but did not estimate what proportion of debtors could have repaid their debts in full from future income.[18]

Two recent studies based on data from bankruptcy petitions provide additional insight into the proportion of bankruptcy cases in which there appear to be affordable debts. A study of 140 cases in the 19th judicial district concluded that 68 percent could "have paid debts if properly motivated and assisted. They owed an average of $11,043 each and had incomes of $17,173 annually."[19]

Another study was made of bankruptcy cases in the Northern Division of the Eastern District of Michigan covering Chapters 7, 11, and 13 filings from October, 1979, to February, 1981. The researchers analyzed 417 Chapter 7 cases and 280 Chapter 11 cases. (Only 12.2 percent of the cases reported unsecured business debts of $500 or more.) The authors conclude: "In all probability, half of these cases could have been liquidated under a Chapter XIII-Wage Earner Plan."[20]

While there have been a number of other studies on consumer bankruptcy, they have not addressed and documented the debtors' ability to repay debts from future income. Nor have studies other than Dolphin's based their analyses on data from personal interviews in addition to the bankruptcy petition. Therefore, this research is the most comprehensive study made of consumer bankruptcies in terms of the numbers and geographical scope of the cases sampled and in terms of the amount of information gathered from both the petitions and personal interviews.

## IV. Conclusion

This study examines the basic policy established in 1898 of permitting consumers to shed their debts through bankruptcy. While the policy has been confronted before, empirical data like those available in this study were not available, and the levels of consumer bankruptcies were much lower than at present. The unique data in this study permit examination of three basic sets of questions relevant to an appraisal of this policy:

(1) To what extent could consumers filing for bankruptcy have paid a reasonable portion of their debts out of anticipated future income? How large are the aggregate amounts of debts that might have been recoverable under a different legislative regimen?

(2) What wealth transfers or subsidies were involved under this legislative regimen? What are the characteristics of consumers who could not have paid their debts and those who apparently could have paid?

(3) How are the markets for consumer credit affected by the policy?

Answers to these questions are directly relevant to the debate on whether there should be a standard of admission to bankruptcy. The data are sterile. They do not represent a value judgment, but they provide a basis for reaching a value judgment.

## FOOTNOTES

[1] Sidney Homer, A History of Interest Rates (New Brunswick: Rutgers University Press, 1963), p. 27.

[2] John M. Houkes, Manuscript in preparation, Purdue University.

[3] Ibid. Note also the provision for a misharum once every seven years, an interval provided in the Bankruptcy Act of 1978 in the United States and in Deuteronomy 15:1-- At the end of every seven years you shall grant a release. And this is the manner of the release: every creditor shall release what he has lent to his neighbor; he shall not exact it of his neighbor, his brother, because the Lord's release has been proclaimed. Of a foreigner you may exact it; but whatever of yours is with your brother your hand shall release."

[4] Webster's Third International Dictionary (Unabridged), p. 172.

[5] Encyclopedia Britannica, 2 (Chicago: Encyclopedia Britannica, Inc., 1982), p. 695.

[6] Ibid.

[7] Ibid., p. 695

[8] 9 Am Jur 2d, para. 2

[9] Frank R. Kennedy, "New Bankruptcy Act Impact on Consumer Credit," Business Lawyer 33 (February 1978), p. 1060.

[10] Report of the Commission on the Bankruptcy Laws of the United States. Washington, D.C.: U.S. Government Printing Office, 1973. 2 vols. Hereinafter referred to as Bankruptcy Commission Report. This Report also has an excellent review of the philosophy of the Bankruptcy Act, II, pp. 85-102

[11] The Compliance Handbook for Consumer Bankruptcy (Washington, D.C.: Capitol Reports, Inc., 1980), p. 30. These provisions may be modified by technical amendments.

## FOOTNOTES (cont'd)

[12] Vern Countryman, "Legal Relief: Straight Bankruptcy and Wage Earner Plans," *Business Lawyer* 26 (January 1971), p. 939.
Richard E. Poulos, referee in Bankruptcy, Portland, Maine, has listed the benefits of a wage earner plan (Chapter 13 under the Bankruptcy Act of 1978) as follows:

1. An extension of some 3 years for payment of debts....
2. No wage attachments or repossessions are permitted....
3. Elimination of all interest and finance charges on all claims classified as unsecured, as determined by the court....
4. Determination of all disputed claims under control and supervision of the trustee and the court....
5. Consolidation of payments to central agency--trustee--where detailed records, open to interested persons, are maintained.
6. Flexibility of plan to allow for suspension and reductions of payments as permitted by the court after notice to creditors.
7. Supervision of purchases of necessities under program geared to avoid further accumulation of debts.
8. Discharge of all debts upon completion of the plan.
9. The moderate cost of this program....

House Hearings, 1967, p. 87.

*Wage Earner Plans Under the Bankruptcy Act*, Hearings before Subcommittee No. 4 of the Committee on the Judiciary, House of Representatives, 90th Cong., 1st Sess. on H.R. 1057 and H.R. 5771, May 24 and 25, 1967. Washington, D.C.: U.S. Government Printing Office, 1967. p. 87. Hereinafter cited as House Hearings, 1967.

[13] Robert Dolphin, Jr., *An Analysis of Economic and Personal Factors Leading to Consumer Bankruptcy*. East Lansing, MI: Bureau of Business and Economic Research, Michigan State University, 1965.

[14] *Ibid.*, p. 98.

[15] *Ibid.*

[16] John J. Brosky, *A Study of Bankrutpcy in the Seattle Metropolitan Area*. Seattle: Retail Credit Association of Seattle, 1965, p. 68.

[17] Grant L. Misbach, *Personal Bankruptcy in the United States and Utah*. Salt Lake City: University of Utah Press, 1964.

[18] Edward W. Reed, *Personal Bankruptcies in Oregon*. Eugene, Ore: University of Oregon Press, 1967.

FOOTNOTES (cont'd)

[19] Family Debt Counselors of Greater Baton Rouge, Inc., "Limited Study of Bankruptcy Filings 19th Judicial District." The study covers cases filed from June 17 to August 29, 1980 and from December 31, 1980 through February 27, 1981. Interestingly, as will be seen in Exhibit 3-8 of this study, among petitioners who could repay at least 100 percent of their nonmortgage debts over five years, the average nonmortgage, nonbusiness debt was $11,945 and the average taxable income was $17,059, figures very close to that reported in the Louisiana study.

[20] Credit Bureau of Saginaw, Community Services, "An Analysis of Chapter Seven and Eleven Bankruptcies Filed in the Northern Division of Eastern District of Michigan from October 1979 to February 1981," p. 34.

# CHAPTER 2

# SAMPLING DESIGN AND INTERVIEW PROCEDURES

Blair Shick, Esq.*

The data for the research were drawn from personal interview responses of 1,199 Chapter 7 individual (nonbusiness) bankruptcy petitioners. Related data bases included information from the petitions filed by those interviewed, from the credit reports of interviews who authorized their release, and from the petitions of those who declined the request to participate in the interview.

The survey base consisted of approximately sixty petitioners from each of 20 federal judicial districts. To establish this sample, two judicial districts were selected from each of ten states. The petitioners interviewed were selected from the examination calendars for 91 different hearing sites under the jurisdiction of 47 different bankruptcy courts within the 20 districts.

This chapter describes the criteria used for the sampling design and the procedures followed in preparation and execution of the interview program and in establishment of the related data bases.

## I. Basis for Selection of States and Judicial Districts

A major objective of the research was to compare and contrast the characteristics of bankruptcies among states with differing levels of exempt property--property that the debtor is allowed to retain without being sold to satisfy debts. This led to a search for states with differing exempt property laws. Another objective was to assess evidence of differences among bankruptcies within a given state.

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*Arthur D. Little, Inc.

## A. States with Two or More Federal Judicial Districts

The federal judicial system is organized in units of judicial districts. Every district is confined to a single state. In some states the judicial district comprises the entire state. Other states have more than one district, each covering a different geographic area in the state. California, New York and Texas, for example, have four federal judicial districts each. Each district has a single U.S. District Court.

The bankruptcy courts are separate departments of the U.S. District Court, but will become adjuncts April 1, 1984. Bankruptcy-related data are collected and reported by the entire district. In fact, the administration of the bankruptcy system is somewhat more decentralized. Bankruptcy Judges[1] and the related clerical staff maintain separate jurisdictions within districts, organized in terms of counties or parishes, that are responsible for the conduct of the bankruptcy proceedings in that area. However, the availability of uniform data for each district argued for the organization of the research design along existing district lines.

Thus, to provide the opportunity to test for differences in bankruptcy profiles within a state, it was determined that only states with two or more districts would be included in the sampling base. Two districts were to be selected in each of ten states with 60 interviews to be conducted in each district, for a total of 120 per state.

## B. Differences in Exempt Property Law

Prior to the 1978 revision of the bankruptcy laws, the determination of the property to be exempt in bankruptcy was governed by state law only. The new Bankruptcy Code established a set of federal standards for exempt property and gave the bankrupt petitioner the option to select either state or federal exemptions standards to govern his or her property in bankruptcy. However, Section 522(b)(1) of the new Code also allowed a state to restrict its citizens to the use of state exempt property standards by legislation specifically denying authorization to use the federal standards. Since the federal standards were perceived to be higher or different from local standards of perceived need in one respect or another,[2] some 15 states had enacted legislation of this kind effective on or about January 1, 1981 (Exhibit 2-1).

EXHIBIT 2-1

STATES WITH EXCLUSIVE EXEMPT PROPERTY STANDARDS*

| | | |
|---|---|---|
| Alabama | Indiana | Ohio |
| Arizona | Kansas | South Dakota |
| Florida | Kentucky | Tennessee |
| Georgia | Louisiana | Virginia |
| Illinois | Nebraska | Wyoming |

*Effective on or before January 1, 1981.

The existence of 15 states with exempt property standards independent of the federal law provided the opportunity to isolate a group of these states for comparision with states where petitioners had the option to select the federal or higher state standards. The decision was to constitute the ten-state sample with five low-exemption and five high-exemption states.

### 1. Selection of low-exemption states

The legislation of the 15 states listed in Exhibit 2-1--those which had effective laws to deny the use of federal exemptions--was examined to assure that their exempt property standards were in fact lower than those in the Bankruptcy Code. A few states, e.g., Arizona, Florida, and Kansas, were eliminated since their homestead exemptions were much higher than the federal, even though their personal property standards were comparable or lower.

The states remaining with low-exempt property standards were then tested against the criterion established calling for two or more judicial districts. In turn, the makeup of each district was analyzed, together with the data on bankruptcy filings in the prior year (July 1, 1979 through June 30, 1980) to assure that adequate numbers of petitioners could be expected to meet the target of 60 interviews within an approximate three-month period. Through this process, the states and districts indicated in Exhibit 2-2 were selected as the sampling base for low-exemption states where interviews were to be conducted.

### 2. Selection of high-exemption states

The next task was to select five other states where at least federal exempt property standards were applicable. Inquiry with lawyers knowledgeable in personal bankruptcy confirmed that no single state could be identified as having standards that would be consistently higher in all property categories than those in the new Bankruptcy Code. California and Texas were identified as states that stood out as having high standards for particularly important property such as residential or household property. This left a range of choices for other states in the high-exemption component of the survey sample.

A major concern in the selection process was to assure that both the economic base and the urban/rural mix of the states and districts selected were substantially similar to that for the low-exemption states. In addition, there was the criterion that two judicial districts be included in each state and that adequate volumes of bankruptcies exist to yield the necessary interviews. The analysis resulted in the selection of the states and districts listed in Exhibit 2-3 as the high-exemption component of the survey base.

## II. Field Investigation And Preparation

### A. Arrangement for Personal Interviews

Experience with individual survey techniques indicates that spontaneity and thoroughness of response are best achieved by personal interviews conducted in the context of the event or circumstances that are the subject of the research. This criterion indicated that a personal interview should be administered at some time during the bankruptcy process--subsequent to the petition filing, but prior to the final discharge. The optimal time seemed to be in the context of a court proceeding, when the subject matter was fresh in the mind of the respondent. In the average case, this would also mean the respondent's attorney might be present--a fact that would lend comfort to the respondent during the interview process.

## EXHIBIT 2-2

## LOW-EXEMPTION STATES IN SURVEY BASE

| State | Exempt Property Standards | Districts |
|---|---|---|
| Georgia | $200 in each household item;<br>$5,000 homestead (head of household only) | Northern<br>Middle |
| Illinois | $1,000 total in personal property;<br>$10,000 homestead (one spouse only) | Northern<br>Central |
| Louisiana | Specified furniture only;<br>$15,000 homestead (one spouse only) | Eastern<br>Western |
| Ohio | $200 in each household item;<br>$5,000 homestead (both may claim) | Northern<br>Southern |
| Virginia | $3,500 total in personal property<br>$5,000 homestead (one spouse only) | Eastern<br>Western |

## EXHIBIT 2-3

## HIGH EXEMPTION STATES IN SURVEY BASE

| State | Districts |
|---|---|
| California | Northern<br>Central |
| New York | Northern<br>Western |
| Pennsylvania | Middle<br>Western |
| Texas | Northern<br>Western |
| Wisconsin | Eastern<br>Western |

### B. The 341 Examination

Under the new Bankruptcy Code, the average consumer Chapter 7 petitioner makes two in-court appearances after the filing of the petition. The first is mandated by Section 341 of the Code, which requires a meeting of creditors where the debtor is required to appear and be examined under oath.[3] The court is not permitted to attend this hearing, which is administered by a bankruptcy trustee or a U.S. Trustee in certain districts. In the typical case, a trustee appointed by a court examines the debtor who, in turn, can be questioned by the creditors.

The second appearance is the discharge or final hearing which, for most purposes, mark the termination of the Chapter 7 bankruptcy proceeding. This hearing is presided over by the court (the bankruptcy Judge). But, due to the rapidly increasing numbers of bankruptcy cases, many Judges had abandoned the notion of individualized hearings and were using a group proceeding, consisting of a number of debtors scheduled to appear simultaneously. This meant that intercept interviews would be difficult to administer at that time. In addition, it was considered that the psychological effect of the finality of the discharge might bias interview responses at this time.

Thus, it was determined that the 341 examination period presented the best opportunity to conduct the interview.

### C. Preinterview Contacts and Data Analysis

A mailing summarizing the research project was forwarded to each bankruptcy Judge in the states and districts selected for the survey base (Appendix A). This was followed by phone contacts to the chief bankruptcy Judge[4] in each district to arrange personal interviews with the court and appropriate representatives of the clerk's office. In most cases, personal contacts were made with the senior bankruptcy Judge assigned to different geographic areas within the districts. Personal arrangements were required by the considerable variation in administration and scheduling of the 341 examinations in the different areas.

The purpose of the visits was to acquaint the different judges with the study, to learn scheduling practices in the different areas, to inspect the hearing sites used for suitability for interviews, to obtain data on the numbers of petitions and hearings in prior reporting periods, and to arrange for advance communication to attorneys and trustees concerning the research and interview program.

The case load experience in the prior year was used to assign interview quotas for each hearing location. For example, if one geographic area within the district had jurisdiction over one-third of the Chapter 7 petitioners in the prior year, that area was scheduled to produce 20 of the 60 interviews administered in that district. The interview schedule was further broken down pro rata where two or more hearing sites (for residents of designated counties) were regularly used within the same area. The intent was to obtain representation in the survey base that was proportional to the actual experience district-wide.

## III. The Interview Process

### A. Pretest of Questionnaire

During the planning stages, a survey instrument was drafted and edited by the different members of the research team. A testing exercise was conducted in the bankruptcy court of Judge Ralph H. Kelly. Chattanooga, in the Eastern District of Tennessee. The draft questionnaire was administered to 20 Chapter 7 petitioners by research team members and professional interviewers. Based on the experience, appropriate revisions were made. A copy of the questionnaire is reprinted in Appendix A. The estimated completion time for the interview was 20 to 22 minutes.

### B. Period of Interviews

The interviews were conducted during the period of May 20 through August 2, 1981. Because of variations in the scheduling frequency of 341 examinations--due to case load and geography--the 60 interviews were completed in some districts before those in others. In general, the bulk of the interviews was administered during June and July.

### C. Interview Procedure

All of the 1,199 interviews were conducted by professional interviewers who were residents of the state or district in which the interviews were administered. Over 90 percent of the interviews were conducted at the site of the 341 examination location. Most were administered after the respondents were finished with their formal examination. In some cases, the interviews took place in the same hour but prior to the examination. The interviewer contacted petitioners individually in order to introduce the research program and seek the cooperation to participate in the interview. Attorneys accompanying the petitioner were extended the opportunity to examine the questionnaire and to be present during the interview. In 144 instances, the attorneys were present. If a person declined to participate, the next petitioner scheduled for examination was approached. Altogether, there were 1,050 refusals to the request for the participation in the interview.

A total of 106 interviews were administered in person at locations other than the hearing site--usually in the petitioner's home. Those interviews were all after the 341 examination. The off-site interview procedure was adopted at the request of bankruptcy Judges who were concerned that any on-site arrangement gave an appearance of court sanction or sponsorship. The procedure was to telephone the petitioner and make arrangements for the personal administration of the interview at a convenient location.

### D. Selection of Interview Respondents

The bankruptcy petitioners requested to participate in the interview were selected on the basis of strict hourly and daily quotas established for each 341 examination site. As a general rule, examinations are scheduled on the basis of six to eight petitioners each hour. Depending on the volume of cases for a particular hearing site, the calendar might run anywhere from two to six hours per day.

A maximum of two interviews per hour was established, with the interviews to continue on a given day until the daily quota was reached. The daily quota was determined by comparing the number of petitioners typically scheduled in a day with the overall quota for interviews from that particular site. To illustrate this process, assume a 341 examination location that represented one-third of the Chapter 7 individual bankruptcy petitions heard in the district in the prior judicial year; 20 of the 60 interviews for the district were planned to be conducted at that location. If examinations were scheduled twice monthly at that location--on a half-day basis with an average of 18 petitioners scheduled over a three-hour period--a daily quota of seven interviews was established. The interviews were then administered during the first three successive examination dates scheduled for the particular location following the May 20 start day.

If the first two petitioners contacted in a scheduled hour agreed to participate, the hourly maximum of two interviews was reached and no more interviews were requested of petitioners scheduled for that hour. If an hourly quota was not reached, the daily quota was reduced by that amount and the shortfall in the target established for that particular hearing location was reached by interview(s) conducted during the next scheduled examination date following those planned to fulfill the target. This same procedure was used for selection of participants where off-site interviews were conducted.

## IV. Other Data Bases

### A. Data From Petitioners

After the interviews were completed, the interviewers obtained the petitions filed with the court by each person requested to participate in the interview. The petitions are required to be filed to commence a bankruptcy proceeding and contain information on assets, property declared as exempt, debts, creditors, and the like. Certain data elements were removed from each petition, coded and entered into the data bases established from the interview responses. A copy of a petition code form is shown in Appendix B.

The petitions copied included those for persons who declined to be interviewed. The same data elements were removed from these petitions. The objective was to establish a framework for comparison between those who agreed to be interviewed and those who did not.

### B. Credit Report

A final set of data collected for the research analysis included that from the credit reports of the petitioners who participated in the interview and authorized the release of their credit report. Authorization to obtain a copy of the report was requested at the end of each interview. The form for the authorization is in the questionnaire in Appendix A. Altogether, 912 of the 1,199 interview respondents provided the authorization requested.

## FOOTNOTES

[1] Due to the highly technical nature of bankruptcy, a specialized judiciary is maintained. Bankruptcy Judges are separate from the U.S. District Judges. They are appointed by the President, with the advice and consent of the Senate, and serve a term of 14 years. See 28, U.S.C.A. Sections 151-153.

[2] The Bankruptcy Code exempts, among other property, up to $7,500 in residential property, up to $1,200 in a motor vehicle, up to $200 in any particular item of household goods, clothing and noncommercial animals,up to $500 in personal jewelry, unmatured life insurance values, health aids, and up to $400 (plus any unused amount in the residential property exemption) in any property. See 11 U.S.C.A. Section 522(d).

[3] See 11 U.S.C.A. Sections 341 and 343.

[4] The bankruptcy Judge with seniority in commission in active service, 28 U.S.C.A. Section 155.

# CHAPTER 3

# BANKRUPT DEBTORS' ABILITY TO REPAY DEBTS

Richard L. Peterson*

## I. Overview

The major objective of this chapter is to determine the proportion of their debts that consumers who had filed for Chapter 7 could have repaid out of future income. Estimates are provided to show the percentage of consumers who could have repaid all or a major portion of their non-mortgage debts out of future income. The percentage of consumers who could have repaid their debts out of nonexempt asset holdings is also calculated. In making calculations of consumers' ability to repay out of income, it is assumed that debtors would retain their present income level, keep their current residences, and repay their debts out of income remaining after providing for taxes, housing and utility expenses, necessary child care, alimony (when applicable), extraordinary medical care or child support expenses, and basic (nonhousing) living expenses.

The chapter is organized as follows. Section II presents data on the income and employment status of debtors' who filed for relief under Chapter 7 of the U.S. Bankruptcy Code. It also explains how after-tax income was calculated from information provided by the debtors. Section III explains how individual debtors' "basic living expenses" were estimated. Section IV then shows how income available to repay debts was calculated, while section V presents tables that show (1) the percentage of bankrupt debtors who could have used their available income to repay their debts, other than mortgage and business debts, in full, over different periods of time and (2) the percentages of their total debts that individual debtors could have liquidated at different points in time. Section V also looks at the income and ethnic characteristics of those who could or could not have repaid their debts. Finally, section VI analyzes consumers' abilities to repay debts out of assets rather than income and section VII summarizes the major findings of the chapter. Following section VII, the Appendix uses data obtained from bankruptcy petitions to compare asset, income and debt characteristics of both respondents and nonrespondents to the bankruptcy survey.

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*This chapter was prepared with the assistance of D. A. Black and S. Badrinath. Robert W. Johnson provided many helpful suggestions.

## II. Computation of After-Tax Income

### A. Present and Expected Income

Several sources of income data were available in this study. The primary source was data obtained from respondents' answers to the set of questions presented in Exhibit 3-1. The secondary source of data on income was the bankruptcy petition. All people who file for bankruptcy are required to report their income for each of the two previous years on the bankruptcy petition.

Additional information was also obtained from all respondents on their present employment status, their employment status in the previous 12 months, and their expected level of income at year-end. That information is summarized in Exhibit 3-2.

The data presented in Exhibit 3-2 indicate that the majority of the bankruptcy filings were made by petitioners who were fully employed and had been fully employed for the previous year. Furthermore, the vast majority expected their income either to increase or to remain the same for at least the next six months. Based on their stable employment and optimistic income expectations, we felt it was reasonable to expect that most petitioners' current income levels would be maintained in the future.

## EXHIBIT 3-1

## QUESTIONS RELATING TO TAXABLE AND NONTAXABLE INCOME

---

45a. Have you received any food stamps in the past month?

1 YES
2 NO → SKIP TO Q. 46
x y

IF "YES", ASK:

45b. What was the total value of the food stamps you received last month?

$______
0 DON'T KNOW
x y

46. How much was your family's total income last month from nontaxable sources, such as social security, child support payments, unemployment or workmen's compensation, and welfare? (IF RESPONDENT IS NOT SURE, ASK FOR BEST ESTIMATE.)

$______
0 NONE
9 DON'T KNOW
x y

47. And, how much was your total family income before taxes from all taxable sources last month? (IF RESPONDENT IS NOT SURE, ASK FOR BEST ESTIMATE).

$______
0 NONE
9 DON'T KNOW
x y

48. By December of this year, how likely is it that your total monthly income from all sources will be higher or lower than it was last month? Would you say that it will definitely be higher, probably be higher, probably be lower, definitely be lower, or will it be about the same?

1 DEFINITELY HIGHER
2 PROBABLY HIGHER
3 PROBABLY LOWER
4 DEFINITELY LOWER
5 ABOUT THE SAME
6 DON'T KNOW
x y

IF "HIGHER" OR "LOWER" ON Q. 48, ASK:

49. Do you expect that (increase) (decrease) will be 10% or less or will it be over 10%?

1 10% OR LESS
2 OVER 10%
3 DON'T KNOW
x y

---

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

## EXHIBIT 3-2

## EMPLOYMENT STATUS, RECENT EMPLOYMENT STATUS, AND EXPECTED FUTURE INCOME OF SURVEY RESPONDENTS

---

### I. Full-Time Employment Status: By Petition

| Type of Petition | | One Person Employed Full-Time | Two People Employed Full-Time | At Least One Person Employed Full-Time |
|---|---|---|---|---|
| Single filing (626) | | 471 (75.2%) | XXXX | 471 (75.2%) |
| Joint filing (571) | | 345 (60.4%) | 124 (21.7%) | 469 (82.1%) |
| Unknown (2) | | | | 2 (100%) |
| Total | 1,199 | 816 | 124 | 942 (78.6%) |

### II. Full-Time Workers Employed Continuously for the Previous Year

| If One Person Employed Full-Time | If Two People Employed Full-Time | Total |
|---|---|---|
| 596 (73%) | 106 (85.5%) | 708 (76.6%) |

Thus, over 76.6 percent of full-time workers (58.5 percent of the sample of 1,199) had been employed continuously for the previous year.

### III. Employment Status: By Sex of Respondent (percentage distribution)

| | Male | Female |
|---|---|---|
| Employed full-time | 72% | 41% |
| Employed part-time | 5 | 11 |
| Not employed | 20 | 45 |
| No answer | 3 | 3 |

### IV. Employment Status for Previous 12 Months (percentage distribution)

| | Male | Female |
|---|---|---|
| No answer | 4% | 12% |
| None | 8 | 25 |
| 1-5 months | 13 | 12 |
| 6-8 months | 14 | 9 |
| 9-11 months | 12 | 10 |
| All 12 months* | 49 | 32 |

*Males employed all 12 months totaled 489, and females totaled 322.

EXHIBIT 3-2--Continued

V. Expected Income at Year-End will be

| | |
|---|---|
| Definitely higher | 24% |
| Probably higher | 26 |
| Same | 35 |
| Don't know | 5 |
| Probably lower | 6 |
| Definitely lower | 4 |

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

Further, we felt that such an assumption might well be conservative since a large proportion (50%) of the respondents expected that their incomes would soon rise. Consequently, we based our estimates of petitioners' future income levels on their present income levels.

## B. Computation of After-Tax Income

Calculations of after-tax income were ordinarily made from data on income, dependents, alimony payments, child care expenses and marital status that were provided on the questionnaire. In addition, data on property taxes and medical payments were used in tax calculations if the sum of these two items exceeded the standard deduction. Most tax calculations assumed that the respondent took the standard deduction and earned income subject to social security taxes. Insofar as respondents were able to itemize deductions, their Federal tax liability was overstated and their after-tax income was understated. Assumptions regarding applicable tax tables and the portion of income subject to social security tax also had the effect of overstating Federal taxes and understating after-tax income. Thus, in general, most estimates of after-tax income were too low, if only Federal taxes were considered. However, since state income tax liabilities were not taken into account, on balance, after-tax income estimates were deemed to be approximately correct.

The calculation of after-tax income required several steps: (1) determination of taxable income, (2) determination of social security taxes, (3) determination of marital status and appropriate tax tables, (4) adjustments for alimony and, if applicable, deductible medical and property tax outlays, (5) calculation of Federal tax liabilities, (6) adjustments for child care credits, (7) adjustments in income to allow for alimony payments, social security taxes, Federal taxes net of child care credits, and the receipt of nontaxable income flows.

After-tax income is the amount of income remaining after each of these adjustments has been made. Each adjustment is explained in more detail below.

### 1. Determination of Taxable Income

Whenever possible, present taxable income levels were estimated from information obtained in response to question 47 (Exhibit 3-1). That figure was multiplied by 12 to obtain an estimate of their annual taxable income, and was compared to previous year's income reported on the petition. Unless there were wide discrepancies in the two figures, the questionnaire data were used as an estimate of taxable annual income.

However, in some cases respondents did not provide such data, or provided estimates of their income that diverged widely from the previous years' income levels they had reported on their petition. If respondents did not answer question 47 ("none" and "zero" were both considered answers), 1980 income (as reported on the petition) was used as an estimate of taxable income. Also, if income data reported on the questionnaire exceeded 1980 income levels by 33 percent or more, 1980 petition data were used to estimate taxable income. The 33 percent standard was used to eliminate reporting errors. It may also have eliminated some truly large income increases. For instance, a spouse may have taken a new job. However, such errors were deemed unavoidable since our objective was to prevent overestimates of income from being made.

Finally, if the petition data exceeded the income level reported on the questionnaire by more than 33 percent, a possible income understatement was flagged. Such understatements could have reflected either reporting errors or the reporting of take-home pay rather than taxable income. Because of the 33 percent criterion, the erroneous reporting of take-home pay frequently would not be caught (e.g., it would not be caught if less than 33 percent of the paycheck were withheld). However, the 33 percent allowance was necessary in case hours worked declined (due to less overtime or other factors).

When a 33 percent or greater drop in income was flagged, additional checks were made to see if there was some reason for the large income decline. These checks consisted of a scan of the reasons reported for filing bankruptcy (see Exhibit 3-3).

If the respondent cited a personal, employment, or business-related problem as a reason for filing, the reported decline in income was assumed to be accurate and questionnaire data were used to estimate taxable income. If the respondent reported only credit-related reasons for bankruptcy, then it appeared unlikely that income had declined substantially. In that case, 1980 income data were used to estimate the respondents' taxable income.

In estimating taxable income, only conservative assumptions were made. Thus, no allowance was made for possible income growth, even when 1980 income data were used or respondents said their future income would definitely rise. Also, large increases in income were disallowed automatically while only implausible large decreases in income were

## EXHIBIT 3-3

## REASONS FOR FILING BANKRUPTCY

| Reason Cited (Multiple Responses Allowed) | Percentage of Respondents Saying the Reason Was Important | One of the Most Important |
|---|---|---|
| I. Personal reasons | | |
| A. Medical bills (doctors, hospitals) | 43* | 15 |
| B. Marital problems (divorce, separation, alimony, child support) | 28* | 12 |
| C. Natural disasters (floods, hurricanes) | 2* | 1 |
| D. Death in the family | 4* | 1 |
| E. Addiction or dependency (drugs, gambling, alcohol) | 3* | 1 |
| II. Employment or business problems | | |
| A. Cutback in hours worked | 17* | 5 |
| B. Laid off or fired from work | 27* | 12 |
| C. Own business failed | 15* | 7 |
| D. Employer's business failed | 5* | 2 |
| E. Unable to work due to accident/illness | 21* | 7 |
| F. Lost second income | 16* | 4 |
| III. Credit/financial problems | | |
| A. Bought too much on credit | 44 | 14 |
| B. Credit was too easy to get | 28 | 4 |
| C. Unable to get creditors to extend loans or agree to different payment schedule | 21 | 4 |
| D. Creditors tried to collect their money | 29 | 4 |
| E. Sued by creditors | 23 | 5 |
| F. Wages actually garnished | 13 | 4 |
| G. Some property repossessed | 10 | 1 |
| H. Cosigned on loan that was not paid | 6 | 1 |
| I. Cost of living went up | 45 | 8 |
| J. Other(s) | 19 | 9 |

*If any one of these reasons were cited as important factors in bankruptcy filings, large declines in income were taken as valid estimates of expected taxable income.

NOTE: Totals add to much more than 100 percent because of multiple responses.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

disallowed. Finally, many consumers may have reported take-home pay rather than taxable income. As a result it is likely that pretax income was understated in many cases. Respondents' taxable income averaged $10,409. In contrast respondents' average 1980 income, as reported on petitions, was $13,979.

## 2. Determination of Marital Status and Appropriate Tax Tables

The information provided by respondents on their marital status was used to determine the appropriate Federal income tax tables for calendar year 1980. In particular, single respondents were assumed to use tax table X, married respondents were assumed to use the version of tax table Y that applied to married couples filing jointly, and separated respondents were assumed to use the version of tax table Y that applied to married couples filing separately. Respondents who were divorced, widowed, or living as married were assumed to use tax table X unless they had dependents. If they had dependents they were assumed to use tax table Z for head of households. If the respondent's marital status was unknown, tax table X (for single persons) was used; if anything, that procedure would overstate their potential tax liabilities.

In general, the assignment of tax tables was made so tax liabilities would be overstated rather than understated if critical information was missing. In addition to people for whom marital status was unknown, possible overstatements were made for recent widows and widowers--who are eligible to use joint tax tables for several years--and for separated people who may have filed jointly rather than separately. Also, because 1980 tax tables were used and taxes were cut in 1981, some small overstatements of tax liabilities may have resulted from that source.

### 3. Adjustments for Alimony and Large Deductions

Monthly alimony payments reported on the questionnaire were multiplied by twelve and subtracted from taxable income. Also, to the extent that the sum of property tax payments plus medical expenses exceeded the standard deduction applicable to a person with the respondent's filing status, the excess deductions were also subtracted from taxable income.

### 4. Calculation of Federal Tax Liabilities

The number of dependents times $1,000 was also subtracted from taxable income for each respondent. Then the income tax liability was calculated by referencing the appropriate tax table (X, Y, Z, etc., as described previously). The tax tables automatically allowed each taxpayer to take the appropriate standard deduction. However, if a respondent were able to reduce his or her taxes by itemizing deductions, this procedure would overstate taxes and understate after-tax income.

Because the Federal tax law allows people to claim a tax credit for 20 percent of their child care expenses (up to a maximum credit of $400 per child for up to two children) estimates were made of the magnitude of those credits that each respondent could obtain. Those estimates were based upon the total number of children (one or more than one) claimed as dependents by the respondent as well as on 20 percent of the (annualized) amount of child care expenses that the respondent reported on the questionnaire.

The child care credit was used to offset all Federal income tax liabilities calculated (as previously described) from tax schedules X, Y, or Z. Net tax liabilities (insofar as they were positive) were then subtracted from taxable income to obtain preliminary estimates of after-tax income.

### 5. Adjustments to After-Tax Income

After-tax income was adjusted for social security taxes and for nontaxable income flows. Social security taxes were computed by taking 6.13 percent of the first $22,900 of taxable income. To the extent that taxable income was generated from exempt sources (such as dividends, interest, or other sources reported as income on the bankruptcy petition) or from governments or other employers exempt from social security, social security tax liabilities were overestimated. Nonetheless, because exempt sources could not be easily identified, all taxable income was deemed to be subject to social security taxes, and social security taxes, computed on that basis, were subtracted from income. The annual value of alimony payments was also subtracted from after-tax income. Finally, the annual value of any nontaxable income received by the respondent was added to after-tax income. In addition, for those people who received them, the annual value of food stamps was added to after-tax income.

The final after-tax income measure, then, included taxable income less Federal income taxes, less social security taxes, less alimony, plus nontaxable income, plus the annual value of food stamps. State income taxes, if applicable, were not computed since (1) it was extremely difficult to do so given wide variations in state laws and (2) there were many reasons to believe that Federal taxes were overestimated.

## C. Example of After-Tax Income Calculations

The computation of after-tax income is illustrated for a hypothetical case in Exhibit 3-4, lines 1-10. Line one multiplies monthly income reported on the questionnaire by 12 to obtain annual income. In this case, since petition data and questionnaire data corresponded closely, no adjustment was required. Line two deducted Federal tax exemptions ($1,000/dependent) from taxable income to obtain line three. After determining from marital status data that the applicable tax schedule was schedule Y, and from specific data on medical expenses and property taxes that no extraordinary deductions were necessary, Federal tax liabilities were determined from schedule Y of the 1980 Federal Tncome Tax Tables. That schedule automatically grants the standard deduction to all taxpayers.

Because our hypothetical consumer had child care expenses, his or her taxes were reduced by the applicable child-care credit in line five, to determine the respondent's net Federal income tax liability, line six. Social security taxes were computed and added to total Federal tax liabilities in line seven. If applicable, alimony payments would be included with tax liabilities as an additional subtraction from income at this point. Federal tax liabilities (and, potentially, alimony) were then subtracted from pretax income to obtain after-tax income, line eight. Taxable income was then adjusted upward by adding in nontaxable income, such as workman's compensation or food stanps, in line nine, to obtain "adjusted family money income," line ten.

## III. Calculation of Basic Living Expenses

A critical component in calculations of whether bankrupt debtors had sufficient income available to repay debts is the calculation of their basic living expense requirements. Their income must be sufficiently

## EXHIBIT 3-4

## SAMPLE CALCULATION OF AVAILABLE INCOME FOR NONFARM FAMILY OF FOUR

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### A. Income Available to Apply to Nonmortgage Debts After Covering Basic Living Expenses

| | | |
|---|---|---|
| 1. Family money income before taxes (monthly taxable income, 1,450 x 12) | $17,400 | $17,400 |
| 2. Less: Exemptions (4 x 1,000) | 4,000 | |
| 3. Taxable income (line 3, Schedule TC) (Line 1 - Line 2) | 13,400 | |
| 4. Income tax (Tax Rate Schedule Y) [$1,404 + .21(13,400-11,900)] | 1,719 | |
| 5. Less: Dependent care credit | 400 | |
| 6. Net Federal income tax (Line 4 - Line 5) | 1,319 | |
| 7. Social security tax (.0613 x 17,400) | 1,067 | 2,386 |
| 8. Family money income after taxes (Line 1 - Line 6 - Line 7) | | 15,014 |
| 9. Add: Non-taxable income (workmen's compensation) (75 x 12) | | 900 |
| 10. Adjusted family money income (Line 8 + Line 9) | | 15,914 |
| 11. Basic living expenses (BLE) for low-income families adjusted for number of dependents and differences in cost of living by region and metropolitan/non-metropolitan places of residence | 9,236 | |
| 12. Proportion of BLE assigned to non-housing expenditures (food, clothing, transportation, services, etc.) (.74 x 9,236) | 6,835 | |
| 13. Actual housing costs (Rent, 260 + Utilities, 70)x (12) | 3,960 | |

## EXHIBIT 3-4--*Continued*

| | | |
|---|---|---|
| 14. After-tax basic living expenses (BLE)<br>(Line 12 + Line 13) | 10,795 | |
| 15. Add: Extraordinary expenses<br>(Child care, 170 per mo.) x (12) | 2,040 | |
| 16. Adjusted after-tax BLE<br>(Line 14 + Line 15) | | 12,835 |
| 17. Adjusted income available to apply to non-mortgage debts<br>(Line 10 - Line 16) | | 3,079 |

### B. Income Available to Apply to Non-Mortgage Debts After Covering Basic Living Expenses Plus 20 Percent of Non-Housing Expenses

| | | |
|---|---|---|
| 18. Adjusted family money income (Line 10) | | $15,914 |
| 19. BLE for non-housing expenses (Line 12) | 6,835 | |
| 20. Add: 20% for higher living standard<br>.20 x 6,835 | 1,367 | |
| 21. Add: Actual housing costs (Line 13) | 3,960 | |
| 22. Add: Extraordinary expenses<br>(Line 15) | 2,040 | |
| 23. Adjusted BLE<br>(Line 19 + Line 20 + Line 21 + Line 22) | | 14,202 |
| 24. Adjusted income available to apply to non-mortgage and non-business debts<br>(Line 18 - Line 23) | | $ 1,712 |

high that they can retain their residence, meet key necessary expenditures, and live at the poverty level or modestly above it in other ways while they are repaying their debts.

The calculation of basic living expenses involves several key steps. They are: (1) calculating minimum income requirements for families with the same number of dependents, (2) adjusting that income for intertemporal and interregional variations in prices, (3) calculating present housing costs, (4) substituting present housing expenses for housing expenses implicit in the minimum income calculations, and (5) allowing for necessary child-care expenses, excess child support payments, or excess medical payments which add to basic income needs. These steps are discussed in detail below.

## A. Calculation of Price-Adjusted Minimum Income Requirements

Basic living expense requirements (BLE) were calculated by using the number of the debtor's reported dependents, determined from the questionnaire, in conjunction with estimates of poverty threshold standards for families of different sizes, calculated by the Bureau of the Census.[1] Initially, each respondent was assigned a BLE that was consistent with the poverty threshold for a family of equal size. For instance, the average poverty threshold for a nonfarm family of four was $8,414 in 1980.[2]

At the time the data were collected, the most recent data on poverty thresholds applied to 1979. Thus, an upward adjustment was made in all BLE estimates to reflect changes that occurred in the consumer price index before the study was conducted. The adjustment (an increase of 24 percent in all estimates) reflected the increase in the Consumer Price Index that occurred between mid-1979 and the commencement of the survey (April 1981). This adjustment was deemed appropriate because the Bureau of the Census makes annual revisions in its poverty thresholds by adjusting them upward by the year-to-year change in the Consumer Price Index. Hence, this adjustment was similar to those made by the Bureau of the Census, except it used a slightly longer time period. After adjustment, the poverty threshold for a family of four was $9,159.

However, because the data from the Bureau of Labor Statistics (BLS) indicate that substantial differences exist in the cost of living applicable to different parts of the country, additional adjustments were made to allow for such differences. Regional cost-of-living adjustments were based on BLS data for 1979, which provided detailed comparisons of the relative costs of living applicable to low-income families living in different parts of the country.[3]

Three basic adjustments were made. First the BLE for each respondent who lived in a city with a population under 50,000 was multiplied by the price index applicable to such cities in the region in which he lived. For instance, the BLE of an individual who lived in a small city in California (the west) was adjusted upward by eight percent. The BLE of a respondent who lived in Georgia (the south) was adjusted downward by 11 percent. In Illinois (the northcentral), the nonmetropolitan adjustment was a negative three percent, while in New York (the northeast) the adjustment was a minus one percent. This adjustment was the only one made if the respondent did not live in a standard metropolitan statistical area (SMSA) with a population of 50,000 or more.

The second price adjustment applied only to respondents who lived in major metropolitan statistical areas. The BLS calculates individual price indexes for 24 major cities, several of which were included in our survey. By using information on each respondent's zip code provided on the bankruptcy petition, we were able to determine if the respondent lived in an SMSA for which specific price indexes were available. If the respondent lived in such a city, that city's price index was used to adjust the BLE rather than the nonmetropolitan index described in the preceding paragraph. For instance, the BLE of a respondent who lived in Atlanta, Georgia, was decreased by only eight percent, rather than by the 11 percent applicable to the nonmetropolitan south. Further, the BLE of a respondent who lived in Chicago was increased by two percent rather than reduced by three percent. These adjustments reflected the fact that it cost more to live in specific big cities than in nonmetropolitan areas, while still allowing for regional differentials in the cost of living.

The third adjustment was similar to the adjustment cited in the preceding paragraph, except that it applied to residents of cities for which no specific price index was available. In this case, zip code information was used to determine if the respondent lived in a standard metropolitan statistical area (with a population of 50,000 or more) for which no specific price data were available. If so, the metropolitan price index applicable to metropolitan areas in that region of the country was used to adjust the BLE rather than the nonmetropolitan index. Thus, the BLE of a debtor who lived in Macon, Georgia, was adjusted downward by 5.1 percent rather than by the 11 percent adjustment applicable to southern residents of nonmetropolitan areas. Similarly, the BLE of a resident of Rockford, Illinois was increased by three percent rather than lowered by three percent, as would be the case if the respondent lived in a small town in the northcentral region of the country.

These three adjustments, then, had the effect of relating respondents' BLE levels to differences in the cost of living in different regions of the country, specific cities, and metropolitan vs. nonmetropolitan places of residence. Overall, then, a respondent's BLE was based on family size and adjusted both for intertemporal price changes and for interregional and metropolitan-nonmetropolitan differences in the cost of living for low-income families (Exhibit 3-4, line 11).

## B. Calculation of Present Housing Costs

Respondents to the survey were asked to provide information on their monthly rent, mortgage, and utility expenses (if applicable). In addition, homeowners were asked to provide information on their annual property tax and insurance liabilities. Explicit housing costs for renters were calculated by multiplying rent and any utility payments by 12 and summing (Exhibit 3-4, line 13). Explicit housing costs for homeowners were calculated by multiplying monthly mortgage and utility payments by 12 and summing those figures with their annual property tax and insurance obligations. This information was collected on the questionnaire.

## C. Calculation of Housing-Adjusted Basic Living Expenses

Because required minimum income levels include an allowance for housing expenses, simply adding present housing costs to initially determined BLE levels would provide for a double housing allowance.

Thus, housing-adjusted BLE levels were calculated by adding present housing and utility costs to a fraction of the previously determined BLE.

The fraction used was 74 percent (or 100 percent minus 26 percent). This statistic was based on the fact that the Consumer Expenditure Survey: Interview Survey, 1972-73, conducted by the BLS, showed that shelter and utility expenses for low-income families accounted for at least 26 percent of the expenditures of relatively low income families (see Exhibit 3-5).[4]

The housing-adjusted basic living expense concept, then, assumed that the debtor would make all the mortgage, rent, tax, insurance and utility payments necessary to continue to live in his or her current residence and would spend an amount equal to or greater than government minimum income standards on all other needs (such as food, clothing, and medical expenses). Because all mortgage, rent, insurance, tax and utility payments related to the debtor's current housing were explicitly taken into account (Exhibit 3-4, line 13), an adjustment was made to the initial basic living expense figure (Exhibit 3-4, line 12) to eliminate implicit shelter and utility expenditure allowances. This adjustment was necessary to prevent double counting the costs of shelter.

## D. Alternative Levels of Basic Living Expenses

The assumption that all respondents would live in their present abodes and retain sufficient income after repaying debts to spend at or slightly above government minimum standards for a family of like size provides little leeway for discretionary expenditures. To make sure that individuals would definitely have more income than allowed by the

## EXHIBIT 3-5

## HOUSING EXPENDITURE AS A PERCENTAGE OF TOTAL CONSUMPTION EXPENDITURES (1972-73)

| Income Class | Shelter, Utility, Property Tax and Property Insurance as a Percentage of Consumption |
|---|---|
| Under $3,000 | 34.21% |
| $3,000 - $3,999 | 30.73 |
| $4,000 - $4,999 | 28.83 |
| $5,000 - $5,999 | 28.16 |
| $6,000 - $6,999 | 26.71 |
| $7,000 - $7,999 | 25.28 |
| $8,000 - $9,999 | 25.30 |
| $10,000 - $11,999 | 24.25 |
| $12,000 - $14,999 | 24.00 |
| $15,000 - $19,999 | 23.79 |
| $20,000 - $24,999 | 22.78 |
| $25,000 or more | 23.77 |

SOURCE: U.S. Department of Labor, Bureau of Labor Statistics, Consumer Expenditure Survey: Interview Survey, 1972-73, Volume 1, U.S. Tables, Families Classified by 10 Family Characteristics, Bulletin 1997, Washington, D.C., 1978, Table 1.

government's minimum income threshold, several alternative levels of living standards were calculated. These adjustments added 10 and 20 percent of the nonhousing BLE allowances to the previously calculated basic living expense level (see Exhibit 3-4, line 12 and part B). Thus, these alternative minimal income levels assumed that the debtor could live in the same housing unit, pay utility bills and make expenditures on other items at a rate that was, alternatively, 10 or 20 percent above the government's minimum expenditure standard for a family with the same number of dependents.

## E. Extraordinary Expense Allowances

Some individuals may have extraordinary expenses that raise their minimal income needs. These include such things as child care expenses that must be incurred so parents can work, child support expenses mandated by law, or excessive medical expenses. Adjustments made to the various basic living expense levels to allow for these possibilities are described below.

### 1. Child care expenses

The questionnaire asked respondents to record monthly child care expenses that were necessary so that the parents could work. Provided that no parent were unemployed, this value was multiplied by 12 and added to each previous estimate of basic living expenses. (See Exhibit 3-4, lines 15 and 22. When applicable, extraordinary child support and medical expenses would also be added at this point.)

## 2. Child support expenses

Child support expenses are mandated by law. Thus, such expenses must be made before other expenditures. However, child support costs are made in lieu of direct expenditures on child support, Hence, it would be incorrect to add child support costs to basic living expense estimates because the basic living expense estimates already have been adjusted for the number of dependents in a family. Consequently, only that portion of child support costs that exceeded "usual" dependency allowances was added to BLE estimates. Further, such child support expenses were added only if they were deemed to be extraordinarily large.

"Usual" child support expenses were calculated from government data on poverty thresholds. In 1979, poverty thresholds were approximately $1,300 higher if a family had one additional dependent. Adjusted to April 1981 prices, the $1,300 (when increased by 24 percent for price increases) corresponded to an annual dependency allowance of $1,612 per child. Only those annual child support expenses that exceeded $1,612 times the number of dependents under 17 were considered to exceed child support expenses already allowed in the government statistics. Further, excess child support expenses were only allowed if they exceeded twice that threshold.

The requirement that child support expenses exceed twice the governmental dependent allowance was imposed because it was recognized that not everyone spent the same amount on child support. Some might spend more than that allowed by government threshold income definitions while others might spend less. The average level of expenditures, then, reflects the fact that some people spend more on children and less on other goods, while others do the reverse. Thus, some variation in spending on dependents was considered to be "normal." Adjustment in required living expenses was not considered necessary in "normal" cases. However, if child support requirements were twice as great as those allowed by poverty level definitions, they were considered to be extraordinarily large.

Consequently, whenever questionnaire data indicated that a respondent spent twice as much per dependent on child support as was implied by poverty level definitions, the difference between those expenditures and the implicit dependency allowance was added to the respondents' basic living expense requirement. This adjustment had the effect of adding extraordinarily large child support requirements to minimum income requirements whenever the child support requirements appeared to be excessive.

### 3. Medical expenses

An adjustment in basic living expenses was also made to allow for "excess" medical expenses. This adjustment was made analogously to the excess child support adjustment. From questionnaire data, annual medical expenses were calculated. Those expenses were divided by the number of dependents and were compared to the per capita medical expense allowance in the BLS 1979 low-income cost-of-living computation--after that allowance was adjusted to current dollar figures by changes in medical care costs from 1979 to 1981.[5] If annual medical expenses were "extraordinarily" large (i.e., were twice as great as the average medical allowance per capita), the difference between actual medical expenses and those allowed (on a current value per capita basis) by the low income cost-of-living computation was added to the respondent's basic living expense requirements.

### F. Summary

Each respondent's basic living expenses were calculated by adding his or her explicit housing costs to nonhousing expenditures calculated to (1) equal the government's minimum income standard, (2) exceed that standard by ten percent, and (3) exceed that standard by 20 percent. In addition, necessary child care expenses and excessive child support and medical care expenses were added to each respondent's basic living expenses. All data necessary to make these calculations were obtained from the questionnaire.

## IV. Income Available to Repay Debts

After-tax income that exceeded a respondent's basic living expenses was assumed to be available to repay debts. A different level of income available to repay debts was calculated for each alternative level of basic living expenses considered.

If after-tax income were understated, income available to repay debts would also be understated. Similarly, if minimal income needs were overstated, income available to repay debts would be understated. Conversely, any overstatements of after-tax income or any understatements of basic living expenses would cause estimates of income available to repay debts to be too high.

Because a conscious effort was made to estimate income conservatively, income available to repay debts was understated in many cases. Also, insofar as an individual's basic living expenses include an allowance for the purchase of automobiles or services provided by other durable goods, that individual's capacity to repay the principal on debts acquired to purchase durable goods would be understated. Part of the basic living allowance for auto or household expenses could be allocated to amortize debts used to acquire durable items.

## V. Individuals' Abilities to Repay Nonmortgage Debts

### A. Debtors' Ability to Repay Nonmortgage Debts from Income

Given individuals' income available to repay nonmortgage debts (the difference between their after-tax income and their basic living expenses) questions arise as to (a) what proportion of their debts consumers would repay in three, four, or five years, and (b) what percentage of consumers could repay their debts in full. Before these questions can be answered, the issue of what debts consumers can be expected to repay in a given period of time must first be resolved.

Mortgage payments are included in basic living expenses. Thus, the inclusion of home mortgages with debts to be repaid out of "income available to repay debts," would imply that homeowners should repay their mortgages twice. Further, because of mortgage debts' typically long-maturity, it does not make sense to consider such debts when making calculations of consumers' abilities to repay their debts in full in three, four, or five years. Also, insofar as mortgage debts applied to properties other than the home, the liquidation of those properties (such as second homes, etc.) generally should provide adequate funds to repay those debts--since mortgage lenders typically will not make a mortgage loan unless the value of the secured assets substantially exceeds the value of the mortgage. Similar reasoning applies to business debts, which typically are secured by the assets of the business. Thus, in all subsequent calculations, we focused only on consumer debts. This was done by subtracting all mortgage debts and business debts from the consumer's total debts.[6]

The following exhibits provide estimates of the percentages of consumer debts that bankrupt debtors could repay out of their "income available to repay debts" in three, four, or five years. The top line of each table shows the percentage that could repay their debts in full. The second line shows the percentage that could repay 75-100 percent of their debts. The third line shows the percentage that could repay 50-75 percent of their debts, etc. Finally, the last line of the exhibit shows the percentage that could not repay their debts at all.

Exhibits 3-6, 3-7, 3-8 show the percentage of respondent's who either could repay their nonmortgage, nonbusiness debts in full or repay various portions of their debts out of income left over after they met their basic living expenses. The exhibits also present data on average income and debt holdings. Exhibits 3-6, 3-7, and 3-8 assume three-, four-, and five-year repayment periods, respectively.

Exhibits 3-9, 3-10, and 3-11 are exactly analogous to Exhibits 3-6 to 3-8, except they inflate each respondent's basic living expenses with a 20 percent "cushion" for nonhousing expenditures. Calculations for the case where a ten percent cushion was assumed are not shown. Those results are highly similar to the other results, as repayment capacities are not highly sensitive to the "cushion" assumptions over the range of zero to 20 percent.

## EXHIBIT 3-6

## ABILITY TO REPAY NONMORTGAGE DEBT FROM INCOME IN THREE YEARS AFTER MEETING BASIC LIVING EXPENSES

| Could Repay | Number of Petitioners | Percent of Respondents | Cumulative Percentage | Average Non-mortgage, Non-business Debt | Average Debt Repayable in Three Years | Average Taxable Income | Average Income (After Taxes and Alimony, Plus Nontaxable Income) |
|---|---|---|---|---|---|---|---|
| 100% or more | 217 | 20.3% | 20.3% | $10,527 | All | $17,944 | $15,862 |
| 75-99.9% | 61 | 5.7 | 26.0 | 13,719 | $11,775 | 14,212 | 13,122 |
| 50-74.9% | 57 | 5.3 | 31.3 | 19,044 | 11,638 | 16,072 | 13,775 |
| 25-49.9% | 80 | 7.5 | 38.8 | 26,952 | 10,319 | 14,219 | 13,114 |
| 0.1-24.9% | 97 | 9.1 | 47.9 | 35,545 | 5,387 | 12,064 | 11,221 |
| 0% or less | 558 | 52.1 | 100.0 | 18,776 | None | 5,650 | 6,366 |

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

## EXHIBIT 3-7

## ABILITY TO REPAY NONMORTGAGE DEBTS FROM INCOME IN FOUR YEARS AFTER MEETING BASIC LIVING EXPENSES

| Could Repay | Number of Petitioners | Percent of Respondents | Cumulative Percentage | Average Non-mortgage, Non-business Debt | Average Debt Repayable in Four Years | Average Taxable Income | Average Income (After Taxes and Alimony, Plus Nontaxable Income) |
|---|---|---|---|---|---|---|---|
| 100% or more | 278 | 26.0% | 26.0% | $11,227 | All | $17,125 | $15,261 |
| 75-99.9% | 38 | 3.6 | 29.5 | 17,085 | $15,282 | 15,350 | 13,475 |
| 50-74.9% | 63 | 5.9 | 35.4 | 26,309 | 16,186 | 16,545 | 14,601 |
| 25-49.9% | 57 | 5.3 | 40.7 | 37,588 | 13,054 | 13,339 | 11,861 |
| 0.1-24.9% | 76 | 7.1 | 47.9 | 29,478 | 4,440 | 11,025 | 10,720 |
| 0% or less | 558 | 52.1 | 100.0 | 18.776 | None | 5,650 | 6,366 |

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

## EXHIBIT 3-8

## ABILITY TO REPAY NONMORTGAGE DEBTS FROM INCOME IN FIVE YEARS AFTER MEETING BASIC LIVING EXPENSES

| Could Repay | Number of Petitioners | Percent of Respondents | Cumulative Percentage | Average Non-mortgage, Non-business Debt | Average Debt Repayable in Five Years | Average Taxable Income | Average Income (After Taxes and Alimony, Plus Nontaxable Income) |
|---|---|---|---|---|---|---|---|
| 100% or more | 310 | 29.0% | 29.0% | $11,945 | All | $17,058 | $15,156 |
| 75-99.9% | 44 | 4.1 | 33.1 | 19,420 | $16,444 | 15,335 | 13,544 |
| 50-74.9% | 46 | 4.3 | 37.4 | 30,061 | 19,558 | 14,687 | 13,556 |
| 25-49.9% | 53 | 5.0 | 42.3 | 41,417 | 15,285 | 13,374 | 11,884 |
| 0.1-24.9% | 59 | 5.5 | 47.9 | 28,397 | 4,384 | 10,802 | 10,467 |
| 0% or nothing | 558 | 52.1 | 100.0 | 18,776 | None | 5,650 | 6,366 |

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

## EXHIBIT 3-9

## ABILITY TO REPAY NONMORTGAGE DEBTS FROM INCOME IN THREE YEARS AFTER MEETING BASIC LIVING EXPENSES PLUS A 20 PERCENT CUSHION

| Could Repay | Number of Petitioners | Percent of Respondents | Cumulative Percentage | Average Non-mortgage, Non-business Debt | Average Debt Repayable in Three Years | Average Taxable Income | Average Income (After Taxes and Alimony, Plus Nontaxable Income) |
|---|---|---|---|---|---|---|---|
| 100% or more | 159 | 14.9% | 14.9% | $10,601 | All | $19,037 | $16,612 |
| 75-99.9% | 51 | 4.8 | 19.6 | 12,884 | $11,313 | 15,921 | 14,462 |
| 50-74.9% | 55 | 5.1 | 24.8 | 16,820 | 10,713 | 15,262 | 13,165 |
| 25-49.9% | 77 | 7.2 | 32.0 | 27,965 | 10,319 | 16,546 | 14,846 |
| 0.1-24.9% | 87 | 8.1 | 40.1 | 32,748 | 5,752 | 13,411 | 12,144 |
| 0% or less | 641 | 59.9 | 100.0 | 18,748 | None | 6,268 | 6,888 |

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

## EXHIBIT 3-10

## ABILITY TO REPAY NONMORTGAGE DEBTS FROM INCOME IN FOUR YEARS AFTER MEETING BASIC LIVING EXPENSES PLUS A 20 PERCENT CUSHION

| Could Repay | Number of Petitioners | Percent of Respondents | Cumulative Percentage | Average Non-mortgage, Non-business Debt | Average Debt Repayable in Four Years | Average Taxable Income | Average Income (After Taxes and Alimony, Plus Nontaxable Income) |
|---|---|---|---|---|---|---|---|
| 100% or more | 210 | 19.6% | 19.6% | $11,155 | All | $18,280 | $16,089 |
| 75-99.9% | 42 | 3.9 | 23.6 | 17,947 | $15,858 | 16,225 | 13,965 |
| 50-74.9% | 47 | 4.4 | 27.9 | 25,000 | 15,037 | 16,044 | 13,856 |
| 25-49.9% | 73 | 6.8 | 34.8 | 32,913 | 11,456 | 15,800 | 14,267 |
| 0.1-24.9% | 57 | 5.3 | 40.1 | 28,001 | 5,319 | 12,127 | 11,306 |
| 0% or less | 641 | 59.9 | 100.0 | 18,748 | None | 6,268 | 6,888 |

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

## EXHIBIT 3-11

## ABILITY TO REPAY NONMORTGAGE DEBTS FROM INCOME IN FIVE YEARS AFTER MEETING BASIC LIVING EXPENSES PLUS A 20 PERCENT CUSHION

| Could Repay | Number of Petitioners | Percent of Respondents | Cumulative Percentage | Average Non-mortgage, Non-business Debt | Average Debt Repayable in Five Years | Average Taxable Income | Average Income (After Taxes and Alimony, Plus Nontaxable Income) |
|---|---|---|---|---|---|---|---|
| 100% or more | 242 | 22.6% | 22.6% | $12,153 | All | $17,995 | $15,805 |
| 75-99.9% | 38 | 3.6 | 26.2 | 17,306 | $14,830 | 15,845 | 13,634 |
| 50-74.9% | 46 | 4.3 | 30.5 | 28,824 | 18,254 | 15,718 | 14,638 |
| 25-49.9% | 57 | 5.3 | 35.8 | 40,065 | 14,499 | 15,741 | 13,640 |
| 0.1-24.9% | 46 | 4.3 | 40.1 | 23,085 | 4,960 | 11,781 | 11,059 |
| 0% or less | 641 | 59.9 | 100.0 | 18,748 | None | 6,268 | 6,888 |

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

## B. Minority Debtors' Ability to Repay Nonmortgage Debts From Income

One question that has been raised is whether minority group members would be deemed less or more able to repay debts once their income and basic living expenses had been covered. Consequently, we made a separate analysis of minority debtors' potential ability to repay debts. Exhibit 3-12 presents results of that analysis for Black and Hispanic respondents. That exhibit is comparable to Exhibit 3-8 for the sample as a whole. Exhibit 3-8 was selected for comparison purposes because the maximum percentage of debtors can repay their debts if they repay them over five years and are assumed to spend their income only for their basic living expenses and nonmortgage debt repayment.

Visual comparisons of Exhibits 3-8 and 3-12 suggest that minority group members are almost identical to the bankruptcy sample as a whole in terms of their ability to repay their debts. We found almost identical percentages were able to repay (1) no debts (50.5 percent for minorities and 52.1 percent for the full sample), (2) at least half their debts (38.3 percent for minorities and 37.4 percent for the full sample), and (3) all their nonmortgage debts (30.6 percent for minorities and 29.0 percent for the full sample). Furthermore, average debt and income levels for both those able to repay in full and not able to repay at all were very similar. Thus, it appears that minority group members have exactly equal capacities to repay debts under our assumptions as bankrupt debtors in general.

# EXHIBIT 3-12

## ABILITY TO REPAY NONMORTGAGE DEBTS FROM INCOME IN FIVE YEARS AFTER MEETING BASIC LIVING EXPENSES

## (BLACKS AND HISPANICS ONLY)

| Could Repay | Number of Petitioners | Percent of Respondents | Cumulative Percentage | Average Non-mortgage, Non-business Debt | Average Debt Repayable in Five Years | Average Taxable Income | Average Income (After Taxes and Alimony, Plus Nontaxable Income) |
|---|---|---|---|---|---|---|---|
| 100% or more | 60 | 30.6% | 30.6% | $10,888 | All | $19,696 | $15,664 |
| 75-99.9% | 9 | 4.6 | 35.2 | 11,042 | $ 9,740 | 10,747 | 10,748 |
| 50-74.9% | 6 | 3.1 | 38.3 | 22,480 | 13,318 | 13.907 | 11,533 |
| 25-49.9% | 7 | 3.6 | 41.8 | 14,501 | 5,919 | 9,319 | 9,376 |
| 0.1-24.9% | 15 | 7.7 | 49.5 | 39,057 | 3,237 | 11,351 | 10.618 |
| 0% or less | 99 | 50.5 | 100.0 | 11,609 | None | 6,173 | 6,390 |

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

### C. Debt Repayments as a Percentage of Income

To ensure that our assumptions regarding debt repayment capacity did not impose an inordinate burden on low income people, we calculated the average proportion of income that we assumed would be devoted to debt repayment by various income classes. The results of those calculations are presented in Exhibit 3-13. They indicate that on average, most people (some people with low housing expenses and few dependents might be an exception) with money incomes below $10,000 could not devote any income to repaying debts. In the $10,000-$15,000 income bracket a relatively small proportion of income (2.5 percent to 11.7 percent on average) could be devoted to repaying debts. At income levels of $20,000 or above, the proportion of income devoted to debt repayment increased until it reached 37 percent to 39 percent for respondents with annual incomes over $35,000. Thus, the data in Exhibit 3-13 suggest that assumed debt repayment payment burdens will not fall disproportionally, if at all, on low income consumers. Rather, they will fall most heavily on the relatively well-to-do.

### D. Comparative Levels of Basic Living Expenses

Underlying our assumption that many consumer debts can be repaid out of income is the assumption that consumers will have some money left over after meeting their basic living expenses. Since basic living expenses vary substantially with the number of dependents it is instructive to analyze them, and compare them to living expenses for a family of four to Bureau of Labor Statistics living expenses calculations for a family of four that lives on a typical "lower-income" budget. It also is useful to compare our calculations of basic living expenses to poverty thresholds calculated by the Census Bureau. Relevant data are presented in Exhibit 3-14.

EXHIBIT 3-13

## FREQUENCY DISTRIBUTION SHOWING AVERAGE ABILITY TO REPAY RATIOS BY INCOME

| Annual Income Level (last month's earnings times 12 or last years total income) | Number of Respondents | Average ratio of income in excess of "Basic Living Expenses" to annual income* | Average ratio of income in excess of "Basic Living Expenses plus 20% Cushion" to annual income** |
|---|---|---|---|
| Under $3,000 | 43 | -6.736 | -7.774 |
| $3,000 - $4,999 | 69 | -0.792 | -1.047 |
| $5,000 - $7,499 | 150 | -0.302 | -0.469 |
| $7,500 - $9,999 | 161 | -0.096 | -0.218 |
| $10,000 - $14,999 | 241 | 0.117 | 0.025 |
| $15,000 - $19,999 | 115 | 0.208 | 0.138 |
| $20,000 - $24,999 | 71 | 0.304 | 0.250 |
| $25,000 - $34,999 | 33 | 0.338 | 0.294 |
| $35,000 plus | 17 | 0.394 | 0.370 |

*These ratios equal the average of annual Disposable Income (DI) less annual Basic Living Expenses (BLE) divided by annual income (y), calculated as $\left(\sum_{i=1}^{n} (DI_i - BLE)/y_i\right)/n$ where n equals the number of respondents in each group. Large negative values occur in low income groups because estimates of basic living expenses are very high relative to actual income levels. If key data were lacking or earned income was zero, no calculations were made. Positive values such as the 0.117 for the $10,000 - $14,999 income bracket should be read as indicating that, on average, income in excess of basic living expenses averaged 11.7% of total income for members of that group.

**These calculations are identical to those in the middle column, except that Basic Living Expenses plus a 20 percent confort allowance was subtracted from disposable income instead of just BLE.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

## EXHIBIT 3-14

## AVERAGE LIVING EXPENSES FOR FAMILIES OF DIFFERENT SIZES

| Dependents | Total Number/ Number on Which Calculations Are Based | Basic Living Expenses (April 1981) BLE | BLE + 20 | BLS "Low Income Budget" (Autumn 1980) | Bureau of Census Price Adjusted Poverty Level (April 1981) |
|---|---|---|---|---|---|
| 1 | 257/229 | $ 7,907 | $ 8,562 | | $ 4,567 |
| 2 | 214/187 | 9,698 | 10,518 | | 5,830 |
| 3 | 246/216 | 10,820 | 11,828 | | 7,146 |
| 4 | 256/235 | 13,657 | 14,959 | $14,044 | 9,159 |
| 5 | 122/112 | 14,288 | 15,825 | | 10,833 |
| 6 | 62/56 | 14,802 | 16,528 | | 12,213 |
| Over 6 | 42/37 | 16,351 | 17,431 | | 15,143 |

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

NOTE: Insufficient data on one or more critical items (such as income, dependents, etc.) were available to calculate basic living expenses for all respondents. Hence, the number of respondents on which calculations were based was approximately ten percent less than the number of respondents who fell in each category.

The data presented in Exhibit 3-14 show that basic living expenses calculated for use in this study rise substantially with family size--both because of rising dependent allowances and because of increases in actual housing costs. For a family of four, our calculated basic living expenses plus taxes averaged \$13,657, and basic living expenses plus a 20 percent nonhousing expense "cushion" and taxes averaged \$14,959. These figures bracketed the BLS statistics showing that a typical lower-income family budget called for an income of \$14,044 in Autumn 1980. Adjusting for inflation to April 1981 would imply that the BLS lower-income budget would be approximately \$14,900 for the same point in time as our basic living expense calculations. However, that budget also allowed for some saving and debt repayment so that, on balance, it measured more than is included in our basic living expense calculations. Consequently, we conclude that our basic living expense calculations are both very similar to the BLS's lower income budget. Probably it approximates most closely the cases where a ten percent or 20 percent "comfort" allowance is allowed--which is consistent with the fact that the BLS standard is assumed to be a typical budget, not a basic living expense budget, for a lower-income family.

The data presented in Exhibit 3-14 also show that our basic living expense allowances substantially exceed government poverty threshold calculations. The differences are particularly marked (averaging close to \$4,000 per family) for families with less than six dependents. These differences arose because our calculations assumed that existing housing expenses would be continued.

## VI. Ability to Repay Debts out of Assets

Business debtors frequently are lent money based on their pledge of assets as collateral to guarantee repayment--and are considered insolvent when their liabilities exceed their assets. However, consumer debtors typically do not borrow against assets, but rather, borrow against future income. Nonetheless, the question has arisen as to whether consumer debtors have the ability to repay debts out of assets.

Exhibit 3A-1 in the Appendix indicates that average secured debt holdings on bankruptcy petitions is less than the market value of property used to secure the debt. Thus, it is conceivable that some consumer bankruptcy petitioners could repay their debts by liquidating assets rather than by repaying debts from future income. However, large exemptions in the bankruptcy laws may reduce their need to do so.

Exhibit 3-15 and 3-16 provide some insight into consumers' ability to repay debts from assets, rather than income. Exhibit 3-15 indicates that, after allowing for assets exempt from seizure to repay debts, only 5.3 percent of the bankruptcy petitioners could repay their debts by liquidating their assets. However, Exhibit 3-16 indicates that it would not be wise for most to repay their debts by liquidating assets. Approximately half of the people who could repay their debts from assets could repay none of their debts from income. Thus, if they liquidated their assets, they would have nothing on which to live. Furthermore, only 20 to 28 percent of them would be able to repay their debts in full if they chose to repay debts out of income rather than out of assets.

## EXHIBIT 3-15

## PERCENTAGE OF DEBTORS MEETING SOLVENCY TEST[a]

(PERCENTAGE OF DEBTORS)

| | Number | Percent |
|---|---|---|
| Solvent debtors | 63 | 5.3 |
| Insolvent debtors | 1,127 | 94.7 |
| Totals | 1,190 | 100.0 |

[a] Debtors are categorized as solvent if reported assets, less exemptions, exceeded reported debts. In several cases petition data were not available or usable.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

### EXHIBIT 3-16

### PERCENTAGES OF NONMORTGAGE DEBTS[a] THAT COULD BE REPAID IN 36 MONTHS FROM AVAILABLE INCOME BY DEBTORS CATEGORIZED AS SOLVENT[b]

### (PERCENTAGE OF DEBTORS)

| Percentage of Non-Mortgage Debt Repaid | Basic Living Expense | | | Basic Living Expense Plus 20 Percent of Non-Housing Needs | | |
|---|---|---|---|---|---|---|
| | N | Percent | Cumulative Percentage | N | Percent | Cumulative Percentage |
| 100% or more | 18 | 28.6 | 28.6 | 13 | 20.6 | 20.6 |
| 75% to 99.9% | 7 | 11.1 | 39.7 | 2 | 3.2 | 23.8 |
| 50% to 74.9% | 2 | 3.2 | 42.9 | 3 | 4.8 | 28.6 |
| 25% to 49.9% | 4 | 6.3 | 49.2 | 7 | 11.1 | 39.7 |
| 0% to 24.9% | 2 | 3.2 | 52.4 | 5 | 7.9 | 47.6 |
| None | 30 | 47.6 | 100.0 | 33 | 52.4 | 100.0 |
| Totals | 63 | 100.0 | | 63 | 100.0 | |

[a] Non-mortgage debt excludes mortgage and business debts.

[b] Debtors are categorized as solvent if reported assets, minus exemptions, exceeded reported debts.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

## VII. Summary and Conclusions

Analysis of data from 1,199 bankruptcy petitions and personal interviews indicates that, depending upon the assumptions made, 15 percent to 30 percent of bankrupt debtors probably could repay all of their nonmortgage debts out of their future income, while as many as 37.4 percent of bankrupt debtors probably could repay at least half their debts out of future income. This finding makes sense because a large proportion of the bankruptcy petitioners were employed full-time and most had had at least one wage-earner employed full-time for the previous year. The percentage of people who could repay their debts varied little by racial affiliation.

Because consumers typically borrow aginst future income rather than assets, only five percent of the respondents could repay their debts by liquidating assets, and half of those would not have been able to repay their debts from future income. Thus, overall, it appears that a future income test provides a more equitable test than an assets test in determining which consumers potentially could repay their debts.

## FOOTNOTES

[1] U.S. Department of Commerce, Bureau of the Census, *Current Population Reports, Series P-60, No. 125: Money Income and Poverty Status of Families and Persons in the U.S. 1979*. Washington, D.C., September 11, 1980.

The data used in this study were applicable to the entire U.S. population. This resulted in a substantial overstatement of farm family poverty levels (by 14 percent for a family of four) and a minimal understatement of urban poverty levels (by 0.35 percent for a family of four). Ideally separate poverty levels would be used for farm and nonfarm families, but it was not easy to determine from the questionnaire and petition data which respondents were farmers.

[2] U.S. Department of Commerce, Bureau of the Census, *Current Population Reports Series P-60, No 125, Money, Income and Poverty Status of Families and Persons in the United States, 1980*. Washington, D.C. August, 1980, pp. 39.

[3] U.S. Department of Labor, Bureau of Labor Statistics, *Autumn 1979 Urban Family Budgets and Comparative Indexes for Selected Urban Areas*, Washington, D.C. April 30, 1980, Table 4.

[4] Our objective in calculating housing-adjusted basic living expenses was to ensure that an individual could continue to live in his/her present residence and have enough income to spend an amount equal to or greater than poverty thresholds on other things. While it was relatively easy to determine the poverty thresholds from government data, those data did not indicate what share of those expenditures were assumed to be allocated to different purposes. Only food expenditures (which were initially defined to be one-third of such spending) were known with certainty. Thus, it was necessary to estimate the implicit housing alllowance embodied in the government definition. The best source for doing so was deemed to be the 1972-1973 *Consumer Expenditure Survey* data compiled by the Bureau of Labor Statistics. Those data provide detailed information on spending by families of different income levels for use in preparing the Consumer Price Index (CPI).

Exhibit 3-5 shows the proportion of total consumption expenditures allocated to shelter, utilities, property taxes, and insurance by housholds in each income group. As can be seen, the proportion of housing related expenses varies inversely with the income level. The poorest people devote a large portion of their total consumption outlays to housing expenditures.

FOOTNOTES (continued)

Because housing expenditures are high for low income poverty level people and the fact that an Indiana welfare agency assumes poor people spend 35 percent of their income on housing, we initially considered using a 35 percent housing adjustment in our calculations. However, the BLS data indicated that people at somewhat higher income levels spend a lower percentage of their income on housing. Consequently, we adopted a 26 percent housing allowance assumption. If anything, that assumption should understate total housing expenses made by families with incomes below $7,500 in 1972-73 dollars. Thus, it should provide a generally low estimate of housing needs for all low income families in 1981. To the extent that the 26 percent assumption actually understates the amount of housing expenses embodied in poverty threshold allowances, it will overstate non-housing expense allowances. Consequently, we used the 26 percent adjustment to ensure that, if anything, the non-housing expense allowances embodied in our "Basic Living Expense" calculations would equal or exceed poverty thresholds.

[5] U.S. Department of Labor "Autumn 1979, Urban Family Budgets," op.cit., Table A.

[6] There was little difference in results obtained when this approach was used and when an alternative approach, which subtracted only first mortgage debts from total debts, was used. Overall, the second approach found that approximately one percent fewer consumers could repay all their debts (except first mortgages) in three to five years than could repay all their debts except mortgage and business debts. The discrepancy was small because most debtors did not have business debts or mortgage debts not secured by their home.

Evidence also exists that many debtors could liquidate their business and investment debts out of assets--even though the alternate calculations did not consider that possibility. While business inventories averaged slightly less than business debts, both second houses and investment assets were worth considerably more than related debts (see the Appendix).

# CHAPTER 3 APPENDIX

## COMPARISON OF RESPONDENTS AND NONRESPONDENTS

An important issue to investigate is whether the 1,199 bankrupt debtors who were approached and consented to an interview were representative of bankrupt debtors in general. If the 1,050 petitioners who declined an interview differed systematically from those who accepted, the generality of the survey's results could be questioned.

Thus, the survey design called for obtaining as much information as possible on debtors who declined interviews as well as on people who accepted. This objective was accomplished by coding as much data as possible from the bankruptcy petitions of both those people who responded affirmatively to a request for an interview and those people who declined. Exhibit 3A-1 summarizes key responses for each of the two groups.

Basically, the data presented in Exhibit 3A-1 suggest that there were great similarities among respondents and nonrespondents to the survey. Their 1980 average incomes (which was the primary determinant of their ability to repay debts) were practically identical. In addition, both groups were very likely to use lawyers, each group had slightly over 10 percent who had previously declared bankruptcy, and the incidence of unusual transfers and surrenders of property prior to bankruptcy was very similar for both groups. The two groups differed, however, in the extent of their average indebtedness.

Based on average data, it appeared that the nonrespondents held more debt, and also more assets, than the respondents. However, the averages are somewhat misleading because the nonrespondent sample contained more people with very large debts. In particular, 2.2 percent of the nonrespondents had over $300,000 worth of debts while only 0.6 percent of the respondents had that much debt. Because every $1 million in debts adds $1,000 to the average debt statistics, a relatively small number of large debts can inflate the average debt statistics substantially.

Consequently, when the distribution of debt statistics is examined in more detail it appears that average debts for the two samples are more similar than might otherwise be apparent. In particular, looking only at people with debts under $50,000, the average debt holdings of both respondents and nonrespondents were in the $15,000 range. The nonrespondents differed mainly in that 77 percent of their number fell in this category, while 84.9 percent of the respondents held less than $50,000 in debt.

Average debt holdings of respondents in each debt category usually were also very similar. However, the percentage of consumers holding large amounts of debt was generally higher for nonrespondents than for respondents. For instance, 10.6 percent of the nonrespondents had debts over $100,000 while only 5.5 percent of the respondents had debts that large. There was also a slightly higher percentage of business-related filings (7.7 percent to 6.0 percent) among the nonrespondents, and slightly more (29.3 percent vs. 27.5 percent) were homeowners. These two factors could have accounted for much of the discrepancy in large debtors that existed in the two samples.

Additional analysis of debtors with over $500,000 in debts indicated that several had lost lawsuits while others had suffered from unincorporated business losses. Probably their prior legal difficulties had made such petitioners unwilling to spend any additional time in court. As a result, nonrespondents in this group outnumbered respondents by eight to two.

Overall, then, most characteristics of debtors in the two samples were highly similar. On average, the nonrespondents held more debts, but this mainly reflected the fact that large debtors were less likely to respond. Since incomes were nearly identical and the vast majority of people held similar amounts of debt, the differences in the nonrespondents were expected to have little effect on calculations of the percentage of people who could repay their nonmortgage, nonbusiness debts.

## EXHIBIT 3A-1

## COMPARISON OF BANKRUPTCY PETITION DATA FOR SURVEY RESPONDENTS AND NONRESPONDENTS

| | Respondents (1199) | Nonrespondents (1050) |
|---|---|---|
| Average taxable income: | | |
| Wages | 13,101.07 (1084) | 13,172.27 (905) |
| Other | 758.00 (1041) | 697.05 (889) |
| Total | 13,979.29 (1014) | 13,924.47 (860) |
| Average assets: | | |
| Total | 15,767.39 (1182) | 19,670.66 (1019) |
| Real | 10,309.91 (1185) | 14,504.44 (1019) |
| Average exemptions | 7,035.91 (1168) | 7,884.77 (981) |
| Average debt: | | |
| Secured debt A2 (p46) | 15,260.44 (1189) | 20,033.75 (1026) |
| Unsecured debt A3 | 14,657.06 (1191) | 23,316.79 (1028) |
| Total | 30,245.59 (1191) | 43,608.59 (1028) |
| Total debt distribution: | | |
| Under 50,000 | 15,274 (1010-84.9%) | 15,824 (809-77.0%) |
| 50,000-100,000 | 67,358 (117-9.6%) | 68,405 (130-12.4%) |
| 100,000-200,000 | 130,261 (35-2.9%) | 131,950 (52-5.0%) |
| 200,000-300,000 | 240,172 (14-1.2%) | 235,314 (14-1.3%) |
| 300,000-400,000 | 365,893 (1-0.1%) | 342,143 (9-0.9%) |
| 400,000-500,000 | 418,904 (4-0.3%) | 444,562 (6-0.6%) |
| 500,000 + | 1,314,686 (2-0.2%) | 904,046 (8-0.8%) |
| Debt except mortgages and business | 19,050.71 (1191) | 30,906.02 (1028) |
| Debt except first mortgages | 22,215.59 (1191) | 34,059.59 (1028) 1 missing |
| Homeownership: | | |
| 1st mortgage amount | 25,794.38 (332) | 28,752.13 (307) |
| Value of house | 36,776.51 (288) | 40,152.76 (271) |
| 2nd mortgage amount | 16,330.97 (92) | 19,354.35 (107) |
| Value of house | 52,360.92 (77) | 52,192.32 (89) |
| Second house amount | 29,403.10 (10) | 27,261.93 (14) |

EXHIBIT 3A-1--Continued

| | Respondents (1199) | | Nonrespondents (1050) | |
|---|---|---|---|---|
| Secured debt amount (p55) | 15,280.68 | (1188) | 19,910.38 | (1026) |
| Market value of secured items | 15,594.52 | (1040) | 19,920.00 | (911) |
| Business debt (inventories) | 22,466 | (26) | 13,463 | (24) |
| Business inventory values | 18,154 | (19) | 10,258 | (18) |
| Investment property debts | 22,760 | (30) | 24,928 | (35) |
| Investment property values | 33,575 | (25) | 42,916 | (26) |
| | Other Data | | | |
| Legal services used | 95.8% | (1177) | 97.7% | (1027) |
| Legal fees | $381.37 | (1007) | $424.00 | (902) |
| Business form used | 6% | (1199) | 7.7% | (1029) |
| Prior bankruptcy (bus. form) | 7.1% | (56) | 10.4% | (77) |
| Prior bankruptcy (standard) | 10.8% | (1094) | 11.2% | (916) |
| Overall, prior bankruptcy (%) | 10.2% | (1199) | 10.8% | (1029) |
| Property garnished | 32.9% | (1108) | 32.4% | (931) |
| Unusual gifts | 1.5% | (1112) | 1.6% | (930) |
| Other transfers | 9.2% | (1103) | 11.9% | (933) |
| Voluntarily surrendered property | 19.3% | (1115) | 20.4% | (933) |

EXHIBIT 3A-1--*Continued*

Distribution of Debt Except Mortgage and Business Debt
(Based on Total Debt)

| Total Debt ($) | Nonmortgage Nonbusiness Debt ($) | All Debt Except First Mortgages ($) |
|---|---|---|
| Under 50,000 | 9,503 | 10,917 |
| 50 - 100,000 | 33,208 | 38,235 |
| 100-200,000 | 84,421 | 92,775 |
| 200-300,000 | 160,293 | 154,824 |
| 300-400,000 | 272,083 | 291,339 |
| 400-500,000 | 261,550 | 406,448 |
| 500,000 + | 1,299,236 | 739,827 |

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

# CHAPTER 4

# PUBLIC POLICY ISSUES

Robert W. Johnson

The basic issue to be examined is as follows: Should debtors be barred from electing bankruptcy if they could pay a reasonable portion of their debts out of anticipated future income? To reach a judgment concerning this issue, three questions need to be answered on the basis of empirical evidence. First, are the aggregate dollar amounts of affordable debts high enough to warrant consideration of a change in the legislative regimen? Second, what are the subsidies or wealth transfers involved under the present system? Are they desirable from the point of view of public policy? Third, how are the markets for consumer credit affected by the current policy of permitting debtors to file for bankruptcy? This chapter addresses each of these issues in turn. It concludes by explaining how the empirical evidence from this study relates to the public policy issues.

## I. Aggregate Impact of Consumer Bankruptcies

### A. Annual Dollar Amounts of Chapter 7 Debts

#### 1. Nonmortgage debt owed by petitioners in sample

The first step in estimating the annual dollar amounts of debts involved in consumer bankruptcies was to calculate the total nonmortgage and nonbusiness debts owed by the sample of bankrupts interviewed. As explained in Chapter 3, payments on residential mortgage debts were included in the calculation of debtors' basic living expenses.

Further, it was assumed that other mortgage debts and business debts were payable from the liquidation of the pledged properties.

The data in Exhibit 3-8 show the average amount of nonmortgage, nonbusiness debts outstanding for various sets of debtors, grouped according to the proportions of their repayable debts. (Exhibits 3-6 or 3-7 could have been used for the calculations in this chapter as well.) Multiplying the number of petitioners in each group by their average nonmortgage, nonbusiness debts and then summing those products yields $20.3 million, the aggregate nonmortgage debts owed by the respondents. Details of this calculation are shown in Exhibit 4-1.

It is noteworthy that over half of the nonmortgage debts at the time of filing were clearly uncollectible in that they were owed by consumers whose incomes were insufficient to make payments on nonmortgage debts after meeting basic living expenses and actual housing expenses. At the same time, 18.3 percent of the aggregate debt was owed by petitioners who could have repaid all of their nonmortgage debts in no more than five years--again after meeting basic living and housing expenses.

## 2. Nonmortgage debt owed by all Chapter 7 petitioners

The next step was to estimate the annual number of Chapter 7 cases or filings for 1981 and subsequent years. Since the interviews and petitions were gathered on the basis of cases, it was important to work with aggregate data based on numbers of cases as well, rather than the number of personal bankruptcies. The latter figure would reflect the number of persons filing for bankruptcy. Thus, a single joint

## EXHIBIT 4-1

## TOTAL NONMORTGAGE DEBTS OWED BY PETITIONERS IN SAMPLE, GROUPED BY AFFORDABLE DEBTS REPAYABLE IN FIVE YEARS

(DOLLAR AMOUNTS IN THOUSANDS)

| (1) Could Repay | (2) Number of Petitioners[a] | (3) Average Nonmortgage, Nonbusiness Debt[a] | (4) Aggregate Debts (2)x(3) | (5) Percentage Of Total |
|---|---|---|---|---|
| 100% or more | 310 | $11.9 | $3,703 | 18.3% |
| 75-99.9% | 44 | 19.4 | 854 | 4.2 |
| 50-74.9% | 46 | 30.1 | 1,383 | 6.8 |
| 25-49.9% | 53 | 41.4 | 2,195 | 10.8 |
| 0.1-24.9% | 59 | 28.4 | 1,675 | 8.3 |
| 0% or less | 558 | 18.8 | 10,477 | 51.6 |
| Totals | 1,070 | | $20,288 | 100.0% |

[a] Exhibit 3-8.

NOTE: Details may not add to totals because of rounding.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

filing by husband and wife represents one case, but two personal bankruptcies.

Data on consumer bankruptcies for all of 1981 are not available at this point, but may be estimated from data through November, 1981, provided by the Bankruptcy Division, Administrative Office of the U.S. Courts. Extrapolation of those data to the full year suggests total personal bankruptcies for 1981 of about 450,000. Adjustment for joint filings yields about 315,000 nonbusiness cases, both Chapter 13 and Chapter 7. Given the 208,570 Chapter 7 cases for the first 11 months of 1981, a total of 227,541 cases may be estimated for the year. In the calculations that follow it was assumed that in the future bankruptcy cases would level off at 227,540 per year.[1] Thus, the annual dollar amounts involved in bankruptcies and potential recoveries are based upon this assumed "steady state" level of annual Chapter 7 filings over an indefinite period of time.

It was assumed that the debtors surveyed were adequately representative of debtors filing for Chapter 7 nationally. The assumption seems reasonable in terms of the size of the sample, the test for homogeneity with nonrespondents (see Chapter 3 Appendix), and the location of the respondents (large, populous states, stratified by exemption levels, as explained in Chapter 2).

The next step was to extrapolate to the national experience the \$20.3 million of nonmortgage debts owed by the 1,070 respondents for whom adequate income data were available from the survey:

$$\frac{227{,}540}{1{,}070} \times \$20.3 \text{ million} = \$4{,}317 \text{ million}^{2}$$

Thus, if consumer bankruptcy filings level off at 227,540 annually and the nonmortgage debts per filing remain unchanged, the aggregate nonmortgage debts filed annually under Chapter 7 would amount to about $4.3 billion in 1981 and subsequent years. This is a conservative estimate, since no allowance is made for the effect of inflation in subsequent years on the average amount of debts filed per year.

The figure of $4.3 billion does not precisely represent total bankruptcy losses, since a portion of those debts were secured by such collateral as automobiles, household furnishings and recreational vehicles. Among the first four groups of cases shown in Exhibit 4-1 (those who could repay 25 percent or more of their debts), the dollar amount of secured debts ranged from about 26 percent of total debt from those who could have repaid half to three-quarters of their nonmortgage debt, to about 44 percent for those in the 75-percent-to-99.9-percent repayment group. However, in those cases that the secured debts exceeded the market value of the collateral shown on the petition, the shortfall became an unsecured claim. Also, some of the liens may have been avoided by Section 522(f)(2) of The Bankruptcy Reform act of 1978, specifically

> a nonpossessory, nonpurchase-money security interest in any--
>
> (A) household furnishings, household goods, wearing apparel, appliances, books, animals, crops, musical instruments, or jewelry that are held primarily for the personal, family, or household use of the debtor or a dependent of the debtor;
>
> (B) implements, professional books, or tools, of the trade of the debtor or the trade of a dependent of the debtor; or
>
> (C) professionally prescribed health aids for the debtor or a dependent of the debtor.

Under Section 522(f)(2), these secured debts would also become unsecured claims. Little recovery of unsecured claims can be anticipated under Chapter 7. While some recovery of the remaining secured debts undoubtedly was realized, the amount of secured claims allowed, the value of the collateral approved, its disposition, and ultimate recoveries could not be determined at the time of the 341 hearing, when the data were gathered. Thus, some portion of the $4.3 billion was recoverable under the present legislative regimen, but the amount could not be confidently estimated from the survey data.

### B. Annual Dollar Amount of Potentially Recoverable Chapter 7 Debts

#### 1. Potentially recoverable debts owed by petitioners in sample

If about $4.3 billion represents the amount owed on nonmortgage debts in Chapter 7 cases, (unadjusted for inflation) what portion of this might be recoverable under a different legislative regimen? The first step in addressing this question was to determine the amount of debts that might have been collectible from the sample of Chapter 7 debtors. As shown in Exhibit 4-1, respondents owed about $20.3 million at the time of filing. However, only a portion of this was repayable, in the sense that debtors had income remaining after taxes, basic living expenses, and actual housing costs to apply to debts. The average amounts of affordable debts for respondents grouped by ability to repay over a five-year period are shown in Exhibit 3-8. The aggregate amount of repayable debt for the petitioners was calculated in the same manner shown in Exhibit 4-1.[3] The total repayable debt (as defined in Chapter 3 and including secured debt) for the respondents was $6.4 million, or 31.5 percent of the total debts filed.

However, as a practical matter, it would be unreasonable to expect that all of these debts would be collected. To be conservative, it was assumed that those consumers who could reasonably have paid 75 percent to 100 percent or more of their nonmortgage debts would have paid all of their nonmortgage debts; that consumers who could have paid 25 percent to 75 percent of their debts would have paid only half of their repayable debts; and that all others would have paid nothing. On the basis of these assumptions and the calculations shown in Exhibit 4-2, it was estimated that potentially recoverable nonmortgage debts of the sample petitioners amounted to $5,281.

In summary, analysis of the data for the sample petitioners regarding their nonmortgage, nonbusiness debts, based on a five-year payout yielded the following results:

| | Amounts in thousands of dollars | Percent of total |
|---|---|---|
| Total nonmortgage, nonbusiness debt | $20,288 | 100.0 |
| Repayable debt | 6,395 | 31.5 |
| Potentially recoverable debt | 5,281 | 26.0 |

As shown in Exhibit 4-2, 70 percent of the potentially recoverable debt was owed by consumers who could have repaid 100 percent of their debts within a period of no more than five years. This group of debtors comprised 29 percent of the sample and was the group with the highest average pre-tax income--$17,058 v. $10,409 for the entire sample. These are the debtors who would be vulnerable to a provision denying admission to Chapter 7 to applicants who could pay a reasonable portion of their debts from anticipated future income.

In contrast, under the stated assumptions no debts were recoverable from the future income of the 58 percent of the respondents able to repay less than 25 percent of their nonmortgage debts over five years. On average, these consumers had much lower incomes (an average of $6,143 pre-tax) than those with large amounts of affordable debts(Exhibit 3-8). Because of their inability to repay a reasonable portion of their debts from anticipated future income, these consumers would not be barred from bankruptcy, even if Chapter 7 were available only to people who had little ability to repay their debts.

Based upon the analysis of the debtors surveyed, the conclusions regarding the potential effect of legislative proposals for an admission test to Chapter 7 based on repayable debts may be summarized as follows:

| Vulnerability to proposed admission test | Debtors who could repay | Percent of debtors | Share of nonmortgage debt | Share of potentially recoverable nonmortgage debt |
|---|---|---|---|---|
| Affected | 75% to more than 100% | 33.1% | 22.5% | 83.8% |
| Partially affected | 25% to 74.9% | 9.3 | 17.6 | 16.2 |
| Unaffected | Less than 25% | 57.7 | 59.9 | 0.0 |
| Totals | | 100.0% | 100.0% | 100.0% |

Details do not add to totals because of rounding.

## 2. Potentially recoverable debts of all Chapter 7 petitioners

As in the previous section, the proportion of estimated Chapter 7 filings to the number of sample respondents shown in Exhibit 4-2 was used to estimate total recoverable debts of all Chapter 7 petitioners

## EXHIBIT 4-2

## POTENTIALLY RECOVERABLE NONMORTGAGE DEBTS OWED BY PETITIONERS IN SAMPLE, GROUPED BY RECOVERABLE DEBTS REPAYABLE IN FIVE YEARS

(DOLLAR AMOUNTS IN THOUSANDS)

| (1) Could Repay | (2) Number of Petitioners | (3) Average Nonmortgage Debt[a] | (4) Average Affordable Debt[a] | (5) Recovery Factor[b] | (6) Average Potentially Recoverable Debt | (7) Aggregate Potentially Recoverable Debt (2) x (6) | (8) Percentage Of Total |
|---|---|---|---|---|---|---|---|
| 100% or more | 310 | $11.9 | $11.9 | 100% | 11.9 | $3,703 | 70.1% |
| 75-99.9% | 44 | 19.4 | 16.4 | | 16.4 | 724 | 13.7 |
| 50-74.9% | 46 | 30.1 | 19.6 | 50% | 9.8 | 450 | 8.5 |
| 25-49.9% | 53 | 41.4 | 15.3 | | 7.6 | 405 | 7.7 |
| 0.1-24.9% | 59 | 28.4 | 4.4 | 0% | 0.0 | 0 | 0.0 |
| 0% or less | 558 | 18.8 | 0.0 | | 0.0 | 0 | 0.0 |
| Totals | 1,070 | | | | | $5,281 | 100.0% |

---

[a] Exhibit 3-8, Columns 5, 6.

[b] By assumption

NOTE: Details may not add to totals because of rounding.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

annually--again assuming a steady-state of 227,540 bankruptcy cases annually:

$$\frac{227,540}{1,070} \times \$5.281 \text{ million} = \$1,123 \text{ million}$$

Put another way, out of the $4.3 billion of Chapter 7 debts filed annually, about $1.1 billion--about one-fourth--might be recoverable annually. Estimates of the amounts of nonmortgage and nonbusiness debts that would be potentially recoverable each year under a different legislative regimen vary with the assumptions regarding the basic living expenses, with and without the 20 percent cushion, the period of time over which the debts may be repaid, and the portion of secured claims recoverable under the current regimen. The longer the assumed payment schedule, the larger the amount of potentially recoverable debts. Thus, increasing the payment schedule from 36 months to 60 months raises recoverable debts from about $0.8 billion to $1.1 billion, an increase of about 41 percent (Exhibit 4-3).

The effect of lengthening the payment schedule is even more marked if unsecured debts are considered. If debtors elect Chapter 13 rather than Chapter 7, payment of unsecured debts must follow payment of priority and secured creditors. Data provided by Claude Rice, a leading Chapter 13 trustee, based on over 35,000 Chapter 13 bankruptcy cases filed during 1980 and active on September 11, 1981, show that unsecured creditors would receive 34.7 percent of their allowed claims if the payment plan extended for 36 months, but would receive 77.3 percent of their funds over 48 months, and all of their allowed claims in about 55 months.[4]

### C. Are Affordable Debts High Enough to Warrant Change?

Changing an existing legislative regimen is always costly. There are costs to Congress in studying and making a change and to creditors and consumers in adjusting to a change. Since these costs are likely to occur only during the initial years of implementing the change, they should be annualized to compare to the annual sums potentially recoverable by modifying the bankruptcy system. If Chapter 13 is often substituted for Chapter 7 where affordable debts exist, costs of administering the settlements may increase. However, the fact that in some states there is currently a high proportion of Chapter 13 filings relative to Chapter 7 filings suggests that the increase in costs is not prohibitive.

A direct dollar-for-dollar comparison of annualized costs and benefits is not adequate, *per se*, to justify a change in policy. If the wealth transfer generated by avoidance of debts is from less affluent to more affluent consumers, the dollars sacrificed by the less affluent almost certainly have greater utility to those consumers than the subsidy dollars received by the more affluent who have elected not to pay their debts. This fact could justify a change in the legislative regimen, even if the annualized dollar costs of making the change exceeded the amount of the wealth transfers from avoidance of repayable debts.[5]

## II. Subsidies Generated By Consumer Bankruptcies

As observed in Chapter 1, consumers were accorded the same right to file for Chapter 7 under the 1898 Bankruptcy Act that they now have under The Bankruptcy Reform Act of 1978. Thus, the analysis in this section

## EXHIBIT 4-3

## POTENTIALLY RECOVERABLE NONMORTGAGE DEBTS UNDER DIFFERENT ASSUMPTIONS

(Dollar Amounts in Millions)

| Payment Schedules | Affordable Debts | Percent Of Nonmortgage Debts | Potentially Recoverable Debts[a] |
|---|---|---|---|
| 36 months | | | |
| Basic living expenses | $1,066 | 24.7% | $ 797 |
| Basic living expenses +20%[b] | 822 | 20.4 | 628 |
| 48 months | | | |
| Basic living expenses | 1,234 | 28.6 | 974 |
| Basic living expenses +20%[b] | 1,032 | 23.9 | 804 |
| 60 months | | | |
| Basic living expenses | 1,360 | 31.5 | 1,123 |
| Basic living expenses +20%[b] | 1,148 | 26.6 | 922 |

[a] Under assumptions specified in text.

[b] Of nonhousing expenses.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

applies to the legislative regimen both prior to and following October 1, 1979. It is not an analysis of a change in the regulatory regimen. The unique contribution of this study lies in the breadth and depth of the empirical data available for the economic analysis of the policy of permitting consumers to avoid debts regardless of their ability to repay.

Bankruptcy losses are a cost of doing business, just as are the cost of funds and general operating costs of extending credit and collecting monthly payments. In the competitive market that characterizes consumer credit, credit grantors must cover all of their costs in the rate charged for credit or in the price of goods sold on credit, or shift funds from consumer credit into some other field of economic activity. Thus, all costs of credit grantors must ultimately be paid by consumers. When creditors raise the price of credit to reflect higher costs, consumers who use credit pay for those costs. When creditors divert funds from consumer credit in response to rising costs, those consumers denied credit also pay for those costs by being forced to use less credit than they would otherwise desire. Typically, consumers denied credit are in a higher risk, lower socio-economic class than those permitted to obtain credit.[6]

The wealth transfer has been ably described in the Brookings Institute study of consumer bankruptcies:[7]

> The bankruptcy process operates ... as a kind if redistributive mechanism whereby goods and services are supplied to one group at the expense of another. In personal bankruptcies, the first group consists of persons whose debts are discharged. The losses incurred by the merchants who sell to them are probably made up in part by sales to cash customers at higher prices than would prevail if debt losses were lower. Another part of those losses is borne by responsible users of credit who pay their debts and who bear

> their share in the form of higher credit charges or prices. But the costs of the goods and services consumed by bankrupts may not be distributed uniformly among all borrowers if bankrupts regularly come from a class of high-risk borrowers whose characteristics lenders are quick to recognize and who can obtain credit only by paying a higher charge than other borrowers. In that case the costs may be borne largely by other members of the high-risk group who do repay their debts (or pay cash). It is also conceivable that lenders themselves may bear part of the costs, at least in a period when bankruptcies are increasing rapidly....

Consequently, debates about public policies that affect the levels of bankruptcy losses should not be presented as a conflict between creditors and consumers. In the long run, in a competitive market bankruptcy costs are borne by consumers. The issue is which group of consumers is harmed and which benefits or, in other words, which group of consumers pays the subsidy and which group receives it. In general, consumers who do not pay their debts are subsidized by those who do pay. However, this study goes beyond the Brookings study in that the data permit at least a tentative identification of the two different groups of consumers who receive the subsidy--those who could not pay their debts and those who could apparently pay if they chose to do so.

### A. Subsidies to Consumers Who Could Not Pay Debts

Attention is focused here on two types of costs associated with consumer bankruptcies. First, a large portion of bankruptcy losses arise from debts that consumers cannot repay from future income and which are either unsecured or insufficiently secured. The data presented in Chapter 3 and in this chapter suggest that a majority of the Chapter 7 cases involved unaffordable debts, which comprised about three-fourths of the aggregate amount of nonmortgage and nonbusiness debts filed under Chapter 7. Second, a portion of total nonmortgage debts apparently could have been repaid from future income and were avoidable in the sense that a different legislative regimen might have permitted their avoidance or recovery. The data suggest that in 30 percent to 40 percent of the cases there were potentially recoverable debts which made up about one-fourth of the aggregate amount of nonmortgage and nonbusiness debts filed under Chapter 7.

The data indicate that the nature of the subsidy, or wealth transfer, involved in nonaffordable and affordable debts differs. As shown in Exhibit 3-8 and Exhibit 4-2, most nonaffordable debt was held by consumers with low incomes. They received a wealth transfer from other consumers who paid their debts. At the time of the bankruptcy study in 1981, it is reasonable to estimate that over 90 percent of those consumers with instalment debt had family income greater than the average income of those Chapter 7 debtors with nonaffordable debts.[8] Hence, it is reasonable to conclude that the subsidy to cover charged-off debts that could not be paid was generally from more affluent to the less affluent consumers.

### B. Subsidies to Consumers Who Could Repay Debts

In contrast to consumers with nonaffordable debts, consumers with affordable debts were concentrated in the upper-income levels of the respondents in the 1981 bankruptcy survey. As shown in Exhibit 3-8, their average taxable income was $17,058, compared to only $5,650 for the 52 percent of the cases where no payments could have been made on nonmortgage debts. The average income after taxes of petitioners filing for bankruptcy who could have repaid in full within 36 months exceeded their average nonmortgage and nonbusiness debts by 1.5 times and, for those who could have repaid in full within 60 months, by 1.3 times (Exhibits 3-6 and 3-8).

A substantial portion of the subsidies received by these consumers must have been from less affluent consumers who had, nonetheless, elected to repay their debts. If income levels of families with instalment debt in 1977 are adjusted upwards to reflect the increase in the cost of living from 1977 to June 1981 (when the bankruptcy survey was made), about 22 percent of the families with instalment debt had incomes ranging from $14,950 to $22,400, a range bracketing the average income for debtors who had affordable debts. If the distribution of income among families with instalment debt is extrapolated from the 1977 survey, about one-fourth of families with instalment debt had incomes falling below that bracket.[9] Through higher finance charges or higher prices of goods and services purchased on credit, these less affluent consumers were providing subsidies to higher-income consumers who avoided repayable debts by choosing bankruptcy.

### C. Do the Subsidies Warrant Change?

Whether or not a subsidy is acceptable as a public policy is a value judgment. An admission standard to bankruptcy based on nonaffordable debts would leave untouched the majority of Chapter 7 debtors. For the most part, these are low-income consumers whose basic living costs and actual housing costs absorb their available income, leaving nothing to repay debts. They would all be admitted to bankruptcy, even with an admission standard. Given their socio-economic status, society would probably view the subsidy that they receive as acceptable. Their plight does not call for a change in the bankruptcy system, nor does it mitigate against a nonaffordable debts standard for admission to Chapter 7. Instead, the survey data should be used to determine whether changes might be initiated in the granting of credit to limit the entry of such consumers into the credit market, without at the same time restricting the availability of credit to similarly situated consumers who would repay their debts. This is one of the issues addressed in the second monograph of the Credit Research Center's Bankruptcy Study.

How should one view the subsidy received by the more affluent debtors filing for Chapter 7 who could have repaid a substanital portion of their debts out of future expected income? The amount of subsidy received is nontrivial, probably ranging from $0.6 to $1.1 billion annually, depending upon one's assumptions. Some portion of the subsidy is regressive in that it is from the less affluent to the more affluent. Is this wealth transfer an acceptable product of public policy?

## III. Effect of Consumer Bankruptcies on Market Structure

What type of credit markets will evolve if consumers are permitted to avoid their repayable debts? Only 27 percent of the debtors sampled in this study were homeowners, whereas 72 percent of nonfarm families surveyed in mid-1977 who owed instalment debts were homeowners.[10] Homeownership is a variable frequently found in credit-scoring systems, and the data from this bankruptcy survey support the relevance of that characteristic as a predictor of creditworthiness. In addition, creditors recognize that they are likely to realize very little on unsecured debts in a bankruptcy. Since homeowners can often pledge the equity in their homes, creditors find second mortgages an increasingly attractive form of lending--both because homeowners represent less risk than renters, other things being equal, and because secured creditors will fare better under Chapter 7 than if they were unsecured.

Thus, continuation of a policy that permits consumers to avoid repayable debts will ultimately lead to a two-tiered credit market: one for homeowners and another for nonhomeowners. Relative to consumers in the homeowners market, those in the lower tier will find credit more expensive, less available except through high-priced retailers, and with more onerous terms, such as higher downpayments, shorter maturities, and more frequent demands for cosigners. Many consumers in the legislatively-created lower tier will be perfectly sound credit risks, but will not be sufficiently distinguishable from others in the group for creditors to take a chance in granting them credit on more reasonable terms. These are the consumers who will be most disadvantaged by the policy of permitting others to avoid their debts, regardless of their ability to repay.

## IV. Conclusions

This research has addressed the public policy that permits debtors to file for bankruptcy, even though they could repay a reasonable portion of their debts from anticipated future income. The data from an extensive survey of consumer debtors who filed for bankruptcy have been analyzed to respond to three basic questions:

(1) To what extent could the debtors have repaid a portion of their debts from future income?

(2) What wealth transfers were involved?

(3) How are the credit markets affected by the policy?

The data and their analysis support the following conclusions. First, the amount of potentially recoverable Chapter 7 debts has been estimated to be $1.1 billion annually, assuming a five-year payback. These debts would be recoverable from anticipated future income after meeting basic living expenses and actual housing costs. The estimates vary with the payout period and the size of any cushion provided over and above basic living expenses, with the overall range from $0.6 billion to $1.1 billion annually. The incremental amounts recoverable annually as a result of the proposed change in the legislative regimen would be less by the amounts that would have been realized on secured claims under the present legislative regimen. The collection of unsecured debts is especially sensitive to the payback period; the longer the payback period, the larger the proportion of unsecured debts that would be recovered.

Second, 50 percent to 60 percent of Chapter 7 debtors would be unaffected by the change being considered by the U.S. Congress. These consumers are primarily low-income consumers without adequate income above basic living expenses and housing costs to repay a reasonable portion of their debts. In contrast, about 70 percent of the potentially recoverable debts was owed by those debtors who could have repaid all of their nonmortgage debts over a period of no more than five years. These consumers had substantially higher incomes than those with non-affordable debts and to some extent must have received subsidies from less affluent consumers who elected to repay their debts.

The wealth transfers described highlight a very important point. Appraisal of the proposed changes in the legislative regimen should not be cast as a conflict between debtors and consumers. It is not a case of consumers' gains being creditors' losses, and vice versa. The present system involves wealth transfers between one group of consumer and another, with evidence that the subsidy may be regressive--that less affluent consumers are subsidizing more affluent consumers. At issue is whether that is an acceptable characteristic of bankruptcy policy.

Finally, the losses associated with unsecured credit, along with other economic characteristics of the credit markets (such as rate ceilings) is leading to a greater emphasis on secured lending, particularly second mortgage lending. Since only owners of real estate can offer creditors second mortgage, a two-tiered credit market is evolving, with a consequent disadvantage to consumers who do not own their homes.

Since at least 1650 B.C. consumers have from time to time been permitted to set aside their debts, regardless of their ability to pay. Today, consumers are permitted under Chapter 7 to discharge debts that could have been repaid from future income, simply because expected future income is not a consideration in the Chapter 7 proceedings. This research provides empirical evidence to assess both the size of the wealth transfers involved as a result of that public policy and the nature and direction of the subsidies among consumers brought about by that policy.

# FOOTNOTES

[1] Earlier estimates of bankruptcy cases were based on an erroneous understanding that the series on which calculations were based excluded Chapter 13 cases. On that basis an annual rate of 315,000 cases were estimated. Elimination of Chapter 13 cases reduces the aggregate number by 27.7 percent.

[2] Figures were calculated to the nearest whole dollar, but rounded to the nearest million for purposes of discussion.

[3] To illustrate, the 44 petitioners who could have repaid 75 percent to 99.9 percent of their debt had average affordable debts of $16,444 (Exhibit 3-8). In total they had $723,536 [44 x 16,444] of affordable nonmortgage and nonbusiness debts. Similar calculations for each of the other groups yields the total of such debts for each group. Summing the totals for each group gives the total affordable nonmortgage, nonbusiness debts for all groups in the sample of $6,394,915.

[4] Testimony of Claude Rice before the Subcommittee on Courts, Senate Committee on the Judiciary, October 29, 1981.

[5] In this analysis it is assumed that most of the costs are borne by taxpayers in one way or another. Since the tax structure is progressive, but the wealth transfer evidently regressive, consumer welfare would under this analysis be improved even if the costs borne by taxpayers equalled the dollar amount of the wealth transfers generated by avoidance of affordable debts.

[6] Research suggests that consumers denied access to cash credit turn instead to sales credit, where the cash price of the goods or services sold may be increased to cover the costs of providing credit. Thus, cash buyers subsidize credit buyers. See Richard L. Peterson and Gregory A. Falls, Impact of a Ten Percent Usury Ceiling: Empirical Evidence, Working Paper 40 (W. Lafayette, Ind.: Credit Research Center, Purdue University, 1981).

[7] David T. Stanley and Marjorie Girth, Bankrutpcy: Problem,Process, and Reform (Washington, D.C.: Brookings Institution, 1971), p. 37.

FOOTNOTES (cont'd)

[8] In mid-1977, 92.5 percent of families with instalment debts (excluding credit-card credit) had incomes of $5,000 or more. The weighted average pretax income in mid-1981 of consumers who could have paid less than 25 percent on their nonmortgage debts was $6,143. Given the inflation over the four years, 1977-1981, it is reasonable to conclude that at the time of the bankruptcy survey at least 90 percent of families with instalment debts had incomes that exceeded the average reported for those petitioners with nonaffordable debts. Data for 1977 are from Thomas A. Durkin and Gregory E. Elliehausen, *1977 Consumer Credit Survey* (Washington, D.C.: Federal Reserve System, 1978), p. 94.

[9] The consumer price index, all items, all urban consumers rose 49.5 percent from 1977 to June, 1981. This increase was applied to the income brackets used in the 1977 consumer credit study, thereby raising the brackets from $10,000 - $14,999 to $14,950 - $22,400. If the shape of the income distribution of consumers with debts remained unchanged, but merely shifted upwards with inflation, the data indicate that 25 percent of families with debt fell into lower income brackets in mid-1981. Durkin and Elliehausen, *op. cit.*, p. 94.

[10] Calculated from data tape, Durkin and Elliehausen, *op. cit.*

# APPENDIX A

## LETTER SENT TO BANKRUPTCY JUDGES

Arthur D Little Inc [illegible]

March 25, 1981

Dear Judge

We are writing to invite your support and participation in a significant research effort being undertaken by the Credit Research Center at Purdue University, with the cooperation of Arthur D. Little, Inc. and Opinion Research Corporation. The study is sponsored by a group of industry associations representing businesses which extend credit to consumers. The purpose of this study is to construct, for the first time, a profile of the demographic and economic characteristics of individuals entering bankruptcy proceedings under Chapter 7, and to determine the nature and sources of the information they have regarding the process and consequences of the proceedings.

The study requires administering interviews with a scientifically selected sample of individuals in 20 selected districts throughout the country. Your district has been chosen, and its inclusion in the study is of great importance if the highest quality results are to be attained.

We will ask your assistance in bringing the study to the attention of the attorneys appearing before you and requesting that they cooperate by permitting their clients (if chosen for an interview in the study) to participate. It should be stressed that the identity of the individual clients and their attorneys will be masked throughout the study and in all reports. The information will be under our control at all times, and subject to complete confidentiality as indicated in the attached statement.

Attorneys may attend the interviews with their clients if they desire. The interviews will be arranged to be as convenient in time and location

[illegible] OF MASSACHUSETTS

as possible for participants. The ideal arrangement, we believe, will be to conduct the interview immediately before or after the 341 Hearing in an adjacent room or office. The interview should not last more than 20 minutes and may be shorter in many cases.

Approximately 60 interviews will be conducted in your district within as short a calendar period as possible. We would like to have all interviews completed by the end of May. The interviews will be administered by professional interviewers from Opinion Research Corporation. The persons to be interviewed will be selected by statistical methods intended to provide a representative sample. The list of questions to be asked during the interview is contained in the interview guide enclosed.

We will also need information from the petitions filed by the persons interviewed. Copies of the petitions will be obtained from the Clerk by the professional interviewer.

When all interviews are complete, the information will be consolidated by Opinion Research Corporation at its headquarters in Princeton, New Jersey. Detailed analysis of the information will be made by the Credit Research Center at Purdue University which will serve as the basis of the final report to be made available to you and other interested parties.

If you have questions about the program or its administration within your district, please call Edwin Cox or Blair Shick at Arthur D. Little, Inc. (617-864-5770).

This is a study of importance to all concerned with the bankruptcy process. We sincerely trust you will cooperate in our efforts to insure that we secure useful results of the highest possible quality. You will be contacted by Ed Cox or Blair Shick to arrange a visit with you and the Clerk in your district to make final plans for conducting the interviews.

Sincerely,

CREDIT RESEARCH CENTER

Dr. Robert Johnson, Director

ARTHUR D. LITTLE, INC.

Dr. Edwin Cox
Blair Shick, Esq.

OPINION RESEARCH CORPORATION
(a subsidiary of Arthur D. Little, Inc.)

Sandra Spies, Vice President

Arthur D Little Inc

# THE ECONOMIC IMPACT OF THE BANKRUPTCY CODE

A Research Study by the Credit Research Center, Purdue University

In cooperation with Arthur D. Little, Inc., and Opinion Research Corporation

## PURPOSE

The purpose of this study is to obtain and analyze data on Chapter 7 debtors in order to explore the implementation of the new Bankruptcy Code. At this point evidence concerning alleged abuses of the Code is scattered and largely anecdotal. Any proposed revisions to the Code should be based on empirical evidence drawn from an unbiased sample of Chapter 7 bankrupts. Some specific study objectives include: the extent to which Chapter 7 relief was economically justified; the path debtors followed to bankruptcy; and the effects, if any, on consumers of the exemption levels established by the states.

## METHODOLOGY

The research will be based upon a sample of approximately 1,200 Chapter 7 debtors at 341 Hearings from 20 district courts in 10 states, one-half from states with high exemptions and the other half from states with low exemptions. With the cooperation of the Bankruptcy Judges, Trustees, and attorneys for the debtors, professional interviewers employed by Opinion Research Corporation will conduct a brief interview with each person at the conclusion of the hearing. In addition a copy of each person's bankruptcy petition will be obtained. Once the data from the interview and petition are merged, the name of the debtor will be removed from the data set, so that further analysis will not be based on any personally identifiable information.

## RESPONSIBILITY FOR RESEARCH

The analysis and interpretation of the information gathered during the survey will be the responsibility of the Credit Research Center, Purdue University, in cooperation with Arthur D. Little, Inc., an independent, international research organization. The sampling design, interviewing and compilation of the survey data will be the responsibility of Opinion Research Corporation, a subsidiary of Arthur D. Little, Inc.

Whatever the results, they will be made publicly available through working papers and monographs published by the Credit Research Center.

## STATEMENT OF PRIVACY

As required by the Code of Ethics of the American Association for Public Opinion Research, we will maintain the anonymity of our respondents. No information will be released that in any way might reveal the identity of a respondent.

Opinion Research Corporation is regularly involved in meeting privacy requirements in surveys conducted for the Federal Government. Appropriate techniques from the Federal procedures will be used in this survey to protect respondent anonymity.

# APPENDIX B

# PERSONAL INTERVIEW QUESTIONNAIRE

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Draft 5

## CREDIT STUDY

RESPONDENT'S NAME: ____________________

ADDRESS: ____________________

CITY/STATE: ____________________

DATE: __________ TIME STARTED: __________ TIME ENDED: __________

INTERVIEWER: __________ LENGTH: __________ (MINUTES)

Hello. My name is ____________________ of Opinion Research Corporation in Princeton, New Jersey. We have been requested by the Credit Research Center at Purdue University to conduct a nationwide survey on the subject of personal bankruptcy. As part of this survey, we are talking to people who have filed for bankruptcy so that we might better understand their attitudes and opinions. We are conducting this study with the full approval of the Court in which your case (is being) (was) heard. I want to stress that this survey is completely confidential, and that your answers will not be identified with you by name in any way.

| | | |
|---|---|---|
| A. | Have you already had your hearing today or will you have it after this interview? | 1 ALREADY HAD HEARING<br>2 WILL HAVE HEARING AFTER INTERVIEW |

IDENTIFICATION NUMBERS

☐☐ DISTRICT

☐☐ LOCATION

☐☐☐☐☐ RESPONDENT'S PETITION #

JUDGE'S NAME: ____________________ ☐

--2

(HAND EXHIBIT 1)

1a. On this card we've listed several factors that may or may not have led you to consider bankruptcy. Would you please read each item on the list, and tell me the number next to every factor that was important in your decision.

| | IMPORTANT | MOST IMPORTANT |
|---|---|---|
| **Personal Problems** | | |
| Medical bills (doctors, hospitals) | 1 | 1 |
| Marital problems (divorce, separation, alimony, child support) | 2 | 2 |
| Natural disasters (such as floods, hurricanes) | 3 | 3 |
| Death in the family | 4 | 4 |
| Addiction or dependency (drugs, alcohol, gambling) | 5 | 5 |
| **Employment Problems** | | |
| Cutback in the number of hours worked | 6 | 6 |
| Laid off or fired from work | 7 | 7 |
| Your business failed | 8 | 8 |
| Business that employed you failed | 9 | 9 |
| Unable to work due to illness/accident | 10 | 10 |
| Lost second income | 11 | 11 |
| **Credit/Financial Problems** | | |
| Bought too much on credit | 12 | 12 |
| Credit was too easy to get | 13 | 13 |
| Unable to get creditors to extend loans/ agree to different payment schedule | 14 | 14 |
| Creditors tried to collect their money | 15 | 15 |
| Sued by creditors | 16 | 16 |
| Wages actually garnished | 17 | 17 |
| Some property repossessed | 18 | 18 |
| Cosigned on a loan that wasn't paid | 19 | 19 |
| Cost of living went up | 20 | 20 |
| OTHER(S) (SPECIFY): | | |
| ______________________________ | 21 | 21 |
| ______________________________ | 22 | 22 |
| | x y | x y |

1b. Were there any other factors that led you to consider filing for bankruptcy? (RECORD ABOVE.)

IF MORE THAN ONE REASON GIVEN IN Qs.1a-b, ASK:

2. Of all the factors that led you to consider bankruptcy, which one or two were most important to you?

--3

ASK QUESTION 3 FOR ITEM "a," THEN ASK QUESTIONS 4 AND 5. THEN REPEAT QUESTIONS 3 AND 4/5 FOR EACH OF THE OTHER ("b," "c," "d") ITEMS.

3. Before you filed for bankruptcy, had you heard about (READ ITEM)?

IF "YES," ON Q. 3, ASK:

4. Did you try ________________ before you filed for bankruptcy?

IF "NO," ON Q. 4, ASK:

5. Why didn't you try ____________________?

| | HEARD OF | | TRIED | | WHY NOT |
|---|---|---|---|---|---|
| | YES | NO | YES | NO | |
| a. Credit counseling, where a counseler assists you in cutting back expenses and arranging partial payments | 1<br>x | 2<br>y | 1<br>x | 2<br>y | ☐<br>x y |
| b. Debt consolidation loans, where you take out one loan to pay off all of your creditors and make only one monthly payment | 1<br>x | 2<br>y | 1<br>x | 2<br>y | ☐<br>x y |
| c. Selling assets, such as property and possessions, to pay debts | 1<br>x | 2<br>y | 1<br>x | 2<br>y | ☐<br>x y |
| d. Arranging different payment schedules with some or all of your creditors | 1<br>x | 2<br>y | 1<br>x | 2<br>y | ☐<br>x y |

6. Where did you get the idea to declare bankruptcy? Was it from someone in particular or was it something you read or heard about? (PROBE: From whom or where did you read/hear about it?)

1 READ ARTICLE OR BOOK
2 ADVERTISEMENT IN NEWSPAPER/MAGAZINE
3 ADVERTISEMENT ON RADIO/TELEVISION
4 LAWYER OR LEGAL AID SERVICE
5 FRIEND/RELATIVE/COWORKER
6 CREDIT COUNSELING SERVICE
7 EMPLOYER
8 OWN IDEA/GENERAL KNOWLEDGE/JUST KNEW
9 OTHER (SPECIFY): ________________________________
x y

7. Did you use a lawyer to help you file for bankruptcy?

1 YES
2 NO
x y → SKIP TO Q. 9

IF USED A LAWYER ("1" ON Q. 7), ASK:

8. How did you select your lawyer?

1 HE IS FAMILY LAWYER/USED HIM BEFORE
2 REFERRED BY ANOTHER LAWYER
3 ADVERTISEMENT
4 RECOMMENDED BY FRIEND/RELATIVE/COWORKER
5 FROM THE PHONE BOOK
6 OTHER (SPECIFY): ______________________

x y

9. Instead of the process you are using, there is an alternative legal process. Under that process you could have repaid all or some of your debts over a period of a few years, while still being protected from your creditors. When you were thinking about filing for bankruptcy, did you hear about this process?

1 YES
2 NO
x y → SKIP TO Q. 12

IF "YES" ("1" ON Q. 9), ASK:

10. What was this process called?

1 CHAPTER 13
2 OTHER (SPECIFY): ______________________
3 DON'T KNOW ______________________
x y

11. Why did you decide not to use this process? (DO NOT READ LIST. PROBE: Were there any other reasons?)

1 ATTORNEY ADVISED AGAINST IT
2 SPOUSE/FRIENDS ADVISED AGAINST IT
3 NOT ENOUGH INCOME/DEBTS TOO HIGH/WOULD HAVE TAKEN TOO LONG
4 TO AVOID PAYING CERTAIN CREDITORS
5 NO PARTICULAR REASON
6 OTHER (SPECIFY): ______________________

x y

(HAND EXHIBIT 2)

12. Here is a list of actions which creditors might take against someone who has not met their debt obligation. Would you please read the list and tell me the number of every action taken against you by any of your creditors.

| | CREDITORS DID | IMPORTANT |
|---|---|---|
| Threaten to repossess your personal property | 1 | 1 |
| Actually repossess your personal property | 2 | 2 |
| Seek to collect an unpaid balance after having repossessed some property | 3 | 3 |
| Threaten to foreclose on your home | 4 | 4 |
| Actually foreclose on your home | 5 | 5 |
| Threaten to garnish your wages | 6 | 6 |
| Actually garnish your wages | 7 | 7 |
| Telephone you frequently at home or work | 8 | 8 |
| Come to see you at home or work | 9 | 9 |
| Send you threatening letters | 10 | 10 |
| Contact a cosigner on a loan | 11 | 11 |
| Contact your employer | 12 | 12 |
| Contact a relative | 13 | 13 |
| OTHER (SPECIFY): ______________________ | 14 | 14 |
| NO ACTIONS TAKEN/NONE IMPORTANT | 15 | 15 |
| | x y | x y |

IF "YES" TO ANY STATEMENT ABOVE ("1" THRU "12"), ASK:

13. Which of these actions by your creditors were important in your decision to declare bankruptcy?

14a. In talking with other people who have declared bankruptcy we have found some who told us that one of the reasons they declared bankruptcy was not so much to cancel all their debts as it was to avoid one or more specific creditors. Would you say that this situation applies to you?

1 YES
2 NO → SKIP TO Q. 15
x y

IF "YES," ASK:

14b. Which creditors didn't you want to pay?
(DO NOT READ LIST. CIRCLE ALL THAT APPLY.)

1 BANK
2 SAVINGS & LOAN/MORTGAGE CO.
3 CREDIT UNION
4 FINANCE OR LOAN COMPANY
5 RETAILER/DEALER/CONTRACTOR
6 FRIEND/RELATIVE/COSIGNER
7 DOCTOR/HOSPITAL
8 OTHER (SPECIFY): ______________________
______________________
x y

14c. What is the total amount that you owe this (those) creditor(s)? (IF DON'T KNOW EXACT AMOUNT, ASK FOR BEST ESTIMATE.)

$ ______________________
0 DON'T KNOW
x y

15. In the six months or so before you filed for bankruptcy, did you make any of the following purchases on credit? (READ LIST)

1 House or mobile home
2 Car or
3 Recreational vehicle or motorcycle
4 Home appliance or furniture costing over $200 per item
5 Jewelry, watch or fur costing over $200 per item
6 Vacation airfare, lodging or meals
7 Investment land or property
8 School tuition
9 NONE OF THESE
x y

15a. Did you use over $200 in credit either to get a cash loan or to make other purchases during the past six months? (IF "YES," ASK: What was it for?)

1 YES (SPECIFY): ____________________
____________________
2 NO
x y

(HAND EXHIBIT 3)

16. Which of the assets on the list do you plan to keep through provisions of the law, that is, exemptions, that permit you to keep items up to some dollar value? Just read me the numbers, please.

| | Exemptions | Reaffirmation |
|---|---|---|
| Financial assets | 1 | 1 |
| House or mobile home | 2 | 2 |
| Car | 3 | 3 |
| Truck | 4 | 4 |
| Recreational vehicle or motorcycle | 5 | 5 |
| Furniture or appliances | 6 | 6 |
| Jewelry, watch or furs | 7 | 7 |
| Clothing | 8 | 8 |
| Land or investment property | 9 | 9 |
| Any others? (SPECIFY): ____________________ | 10 | 10 |
| NONE | 11 | 11 |
| DON'T KNOW | 12 | 12 |
| | x y | x y |

17. And which do you plan to keep by agreeing to make payments after bankruptcy is final, sometimes called reaffirmation of the debt?

18. Are there any other creditors you plan to repay? (IF "YES, ASK: Which type of creditors?)

1 NO/NONE
2 BANK
3 SAVINGS & LOAN/MORTGAGE CO.
4 CREDIT UNION
5 FINANCE OR LOAN CO.
6 RETAILER/DEALER/CONTRACTOR
7 RELATIVE/FRIEND/COWORKER
8 DOCTOR/HOSPITAL
9 OTHER (SPECIFY): ____________________
____________________
x y

--/

19. Which of the assets on this list do you expect to lose by filing for bankruptcy? Just read me the numbers please.

1 Financial assets

2 House or mobile home
3 Car
4 Truck
5 Recreational vehicle or motorcycle
6 Furniture or appliances
7 Jewelry, watch or furs

8 Clothing
9 Land or investment property
10 Any others? (SPECIFY):__________

__________________________

11 NONE
12 DON'T KNOW
x y

IF FINANCIAL ASSETS LOST ("1" ON Q. 19),

20. Now, just think about the financial assests you expect to lose, that is, any bank accounts, stocks, bonds, or other financial investments. About how much money do you estimate you will lose? (IF NOT SURE, ASK FOR BEST ESTIMATE.)

$__________
0 DON'T KNOW
x y

IF ANY TYPE OF ASSETS LOST OTHER THAN FINANCIAL ("2-10" ON Q. 19), ASK:

21. Now, think just about personal property you expect to lose, that is, such things as (NAME ITEMS 2-10 CIRCLED in Q. 19). About how much do you think you could get for these goods if you sold them, rather than lost them through bankruptcy? (IF NOT SURE, ASK FOR BEST ESTIMATE.)

$__________
0 DON'T KNOW
x y

22. Compared to your credit situation before you filed for bankruptcy, do you think it will be more difficult or less difficult for you to get credit in the future from each of the following types of creditors?

| | MORE DIFFICULT | LESS DIFFICULT | NO CHANGE/ SAME AS BEFORE | DON'T KNOW |
|---|---|---|---|---|
| Bank | 1 | 2 | 3 | 4 |
| Savings & Loan or Mortgage Company | 1 | 2 | 3 | 4 |
| Credit Union | 1 | 2 | 3 | 4 |
| Finance or Loan Company | 1 | 2 | 3 | 4 |
| Retailer, Dealer, or Contractor | 1 | 2 | 3 | 4 |
| Friends, Family, or Coworkers | 1 | 2 | 3 | 4 |
| Doctor or Hospital | 1 | 2 | 3 | 4 |
| Other (Specify):__________ | 1 | 2 | 3 | 4 |
| __________ | 1 | 2 | 3 | 4 |

23. How did you learn about getting credit in the future? Who or what was your source of information?

1 READ ARTICLE OR BOOK
2 ADVERTISEMENT IN NEWSPAPER/MAGAZINE
3 ADVERTISEMENT ON RADIO/TELEVISION
4 LAWYER OR LEGAL AID SERVICE
5 FRIEND/RELATIVE/COWORKER

6 CREDIT COUNSELING SERVICE
7 OWN IDEA/GENERAL KNOWLEDGE/JUST KNEW
8 OTHER (SPECIFY):__________

__________________________
x y

24. As you probably know, there are credit bureaus which keep track of people's credit experience. Do you think their credit report will show a record of your bankruptcy?

1 YES
2 NO
3 DON'T KNOW
x y

SKIP TO Q. 26

IF YES ("1" ON Q. 24), ASK:

25. For how many years will a record of your bankruptcy be on your credit record?

# ________ YEARS
0 DON'T KNOW
x y

26. Do you know whether or not it would be legal for you to ever file for bankruptcy again?

1 YES
2 NO
3 DON'T KNOW
x y

SKIP TO Q. 29

IF YES ("1" ON Q. 26), ASK:

27. How many years from now could you file for bankruptcy again?

# ________ YEARS
0 DON'T KNOW
x y

28. Would you ever again consider bankruptcy as a solution to your financial problems?

1 YES
2 NO
3 DON'T EXPECT ANY MORE PROBLEMS
4 DON'T INTEND TO LET THIS HAPPEN AGAIN
x y

(HAND EXHIBIT 4)

29. Which number in the first category on this card best describes your current marital status?

1 MARRIED
2 SEPARATED
3 DIVORCED
4 LIVING AS MARRIED
5 SINGLE-NEVER MARRIED
6 WIDOWED
x y

→ SKIP TO Q. 32

IF "1" OR "2" ON Q. 29, ASK:

30. Did you file for bankruptcy for yourself individually, or did you file jointly with your spouse?

1 INDIVIDUALLY
2 JOINTLY → SKIP TO Q. 32
x y

IF FILED "INDIVIDUALLY," ASK:

31a. Did your spouse also file for bankruptcy on (his)(her) own?

1 YES
2 NO → SKIP TO Q. 32
x y

IF "YES," ASK:

31b. Why did (he)(she) file for bankruptcy separately rather than with you in a joint petition?

☐
x y

31c. When and where did (he)(she) file for bankruptcy? (IF DON'T KNOW EXACT DATE, PROBE FOR YEAR AND APPROXIMATE MONTH)

DATE:________________ MONTH:________________ YEAR:________

CITY:________________________ STATE:______________

0 DON'T KNOW x y

32. Have you (or your [former] spouse) ever filed for bankruptcy before? (PROBE: Was it you, your spouse, or both of you jointly?)

1 NEVER FILED BEFORE
2 RESPONDENT FILED INDIVIDUALLY
3 SPOUSE FILED INDIVIDUALLY
4 FILED JOINTLY
5 RESPONDENT FILED JOINTLY WITH FORMER SPOUSE
6 SPOUSE FILED JOINTLY WITH FORMER SPOUSE
x y

IF "MARRIED" OR "SEPARTED" ("1" OR "2" ON Q. 29), ASK QUESTIONS 33-38 FOR BOTH HUSBAND AND WIFE. ALL OTHERS, ASK EACH QUESTION JUST FOR RESPONDENT. RECORD RESPONSES BY SEX.

(HAND EXHIBIT 4)

33. Which number in the middle category on this card contains your (your spouse's) age? Just read me the number, please.

| | MALE | FEMALE |
|---|---|---|
| Under 25 | 1 | 1 |
| 25-34 | 2 | 2 |
| 35-44 | 3 | 3 |
| 45-54 | 4 | 4 |
| 65 or older | 5 | 5 |
| | x y | x y |

34. And which number in the last category of this card describes the level of schooling that you (your spouse) completed?

| | MALE | FEMALE |
|---|---|---|
| Did not finish high school | 1 | 1 |
| High school graduate | 2 | 2 |
| Training or vocational school | 3 | 3 |
| Attended college courses | 4 | 4 |
| College graduate | 5 | 5 |
| Advanced college degree | 6 | 6 |
| | x y | x y |

35. Are you (Is your spouse) now employed, either full- or part-time?

| | MALE | FEMALE |
|---|---|---|
| Employed Full-Time | 1 | 1 |
| Employed Part-Time | 2 | 2 |
| Not Employed | 3 | 3 |
| | x y | x y |

IF RESPONDENT (OR SPOUSE) EMPLOYED, ASK:

35a. What type of work do you (does your spouse) do?

MALE: ______________________ x y ☐

FEMALE: ______________________ x y ☐

35b. Do you (Does your spouse) have a second job?

| | | | | |
|---|---|---|---|---|
| MALE: | 1 YES | 2 NO | x | y |
| FEMALE: | 1 YES | 2 NO | x | y |

IF RESPONDENT (OR SPOUSE) NOT EMPLOYED, ASK:

(HAND EXHIBIT 5)

36. Which of the reasons listed on this card describes why you aren't (your spouse isn't) working? Just read me the number.

| | MALE | FEMALE |
|---|---|---|
| Student | 1 | 1 |
| Retired | 2 | 2 |
| Permanently disabled | 3 | 3 |
| Homemaker/care of children | 4 | 4 |
| Laid off/unable to find work | 5 | 5 |
| On strike | 6 | 6 |
| On sick leave | 7 | 7 |
| My business failed | 8 | 8 |
| Employer's business failed | 9 | 9 |
| OTHER REASON (SPECIFY): | 0 | 0 |
| ______________________________ | | |
| ______________________________ | x y | x y |

37. How many months out of the past 12 have you (has your spouse) been employed, either full- or part-time?

| | MALE | FEMALE |
|---|---|---|
| # OF MONTHS: | ____ | ____ |
| | x y | x y |

38. Are you (Is your spouse) a member of a credit union?

| | MALE | FEMALE |
|---|---|---|
| YES | 1 | 1 |
| NO | 2 | 2 |
| | x y | x y |

39. How many people, including yourself and any others, are dependent on you for their principal means of support? This is the number of exemptions you report on your Federal income tax form.

# OF DEPENDENTS: ______________ x y

IF MORE THAN JUST RESPONDENT, ASK:

39a. Which of the following are dependent on you for their principal means of support?

1 Spouse
2 Children under 6 years of age (Specify how many:__________)
3 Children age 6-12 (Specify how many:__________)
4 Children age 13-17 (Specify how many:__________)
5 Children over age 17 (Specify how many:__________)
6 Parent (Specify how many:__________)
7 Other (Specify relationship:__________and number:__________)
x y

40. Do you own or rent the dwelling in which [illegible]?

1 OWN → SKIP TO Q. 42
2 RENT
3 NEITHER (LIVE WITH PARENT/ OTHER RENT-FREE) → SKIP TO Q. 43

IF "RENT," ASK:

41. How much do you pay in rent per month?

$ ____________
x y

41a. Does your monthly rent include some or all of your utilities, that is, electricity, gas, oil, water, and telephone?

1 ALL UTILITIES INCLUDED → SKIP TO Q. 43
2 SOME UTILITIES INCLUDED
3 NO UTILITIES INCLUDED
x y

IF "SOME/NO UTILITIES INCLUDED", ASK:

41b. Over and above what is included in your rent payment, about how much do you pay directly for utilities per month? (IF NOT SURE, ASK FOR BEST ESTIMATE. IF CAN'T SPECIFY PER MONTH, ASK FOR BEST ESTIMATE OF TOTAL COST FOR LAST YEAR.)

$____________PER MONTH
OR
$____________LAST YEAR

0 DON'T KNOW
x y

→ SKIP TO Q. 43

IF "OWN" (#1" ON Q. 40), ASK:

42. What is your total monthly mortgage payment? (IF NOT SURE, ASK FOR BEST ESTIMATE)

$____________
x y

42a. Does your monthly mortgage payment include your . . .?

| | INCLUDE YES | INCLUDE NO | | DON'T KNOW | | |
|---|---|---|---|---|---|---|
| a. Property tax | 1 | 2 | $________PER YEAR | 0 | x | y |
| b. Homeowner's insurance | 1 | 2 | $________PER YEAR | 0 | x | y |
| c. All utilities, that is, electricity, gas, oil, water, & telephone | 1 | 2 | $________PER MONTH OR<br>$________LAST YEAR | 0 | x | y |

FOR EACH ITEM NOT INCLUDED IN MORTGAGE, ASK:

42b. About how much do you pay . . .?

(a) Per year for property tax?
(b) Per year for homeowner's insurance?
(c) Per month for any utilities not included in your mortgage? (IF NOT SURE, ASK FOR BEST ESTIMATE. IF CAN'T GIVE MONTHLY COST, ASK FOR BEST ESTIMATE OF TOTAL COST FOR LAST YEAR.)

43. Which, if any, of the following expenses do you usually have each month?

| MONTHLY EXPENSES | | AVERAGE MONTHLY PAYMENT | DON'T KNOW | | |
|---|---|---|---|---|---|
| Alimony | 1 | $ | 0 | x | y |
| Child support | 2 | $ | 0 | x | y |
| Child care because you (or your spouse) work | 3 | $ | 0 | x | y |
| Regular treatment of a long-term or chronic ailment | 4 | $ | 0 | x | y |
| Life or medical insurance | 5 | $ | 0 | x | y |
| Any other regular monthly payments (SPECIFY): | | | 0 | x | y |
| ____________ | 6 | $ | 0 | x | y |
| ____________ | 7 | $ | 0 | x | y |
| ____________ | 8 | $ | 0 | x | y |
| NONE | 9 → SKIP TO Q. 45a | | | | |

FOR EACH MONTHLY EXPENSE, ASK:

44. What is your average monthly payment for ______________?

45a. Have you received any food stamps in the past month?

1 YES
2 NO → SKIP TO Q. 46
x y

IF "YES", ASK:

45b. What was the total value of the food stamps you received last month?

$ ____________
0 DON'T KNOW
x y

46. How much was your family's total income last month from nontaxable sources, such as social security, child support payments, unemployment or workmen's compensation, and welfare? (IF RESPONDENT IS NOT SURE, ASK FOR BEST ESTIMATE.)

$ ____________
0 NONE
9 DON'T KNOW
x y

47. And, how much was your total family income before taxes from all taxable sources last month? (IF RESPONDENT IS NOT SURE, ASK FOR BEST ESTIMATE.)

$ ____________
0 NONE
9 DON'T KNOW
x y

48. By December of this year, how likely is it that your total monthly income from all sources will be higher or lower than it was last month? Would you say that it will definitely be higher, probably be higher, probably be lower, definitely be lower, or will it be about the same?

1 DEFINITELY HIGHER
2 PROBABLY HIGHER
3 PROBABLY LOWER
4 DEFINITELY LOWER
5 ABOUT THE SAME
6 DON'T KNOW
x y

IF "HIGHER" OR "LOWER" ON Q. 48, ASK:

49. Do you expect that (increase) (decrease) will be 10% or less or will it be over 10%?

1 10% OR LESS
2 OVER 10%
3 DON'T KNOW
x y

INTERVIEWER: HAND THE CREDIT REPORT RELEASE FORM TO RESPONDENT(S) AND ASK HIM/HER/THEM TO READ IT AND THEN TO FILL IN THE REQUESTED INFORMATION AND SIGN HIS/HER/THEIR NAME(S).

Thank you very much for your time and cooperation.

RECORD THE FOLLOWING:

RESPONDENT'S SEX: 1 MALE 2 FEMALE

RESPONDENT'S RACE: 1 WHITE 2 BLACK 3 HISPANIC 4 OTHER

WILL RELEASE CREDIT REPORT: 1 YES 2 NO x y

ATTORNEY ATTENDED THE INTERVIEW: 1 YES 2 NO

INTERVIEWER: ON A SCALE OF "1" to "5", HOW WOULD YOU DESCRIBE HOW OPEN AND COOPERATIVE THIS RESPONDENT WAS DURING THE INTERVIEW?

| | | | | | | |
|---|---|---|---|---|---|---|
| VERY OPEN/<br>VERY COOPERATIVE | 1 | 2 | 3 | 4 | 5 | NOT AT ALL OPEN/<br>VERY UNCOOPERATIVE |

INTERVIEWER: ATTACH RESPONDENT'S CREDIT REPORT RELEASE FORM AND A COPY OF HIS/HER BANKRUPTCY PETITION (WHICH YOU MUST OBTAIN FROM THE CLERK OR XEROX) TO THIS QUESTIONNAIRE.

## EXHIBIT 1

### Personal Problems

1 Medical bills (doctors, hospitals)
2 Marital problems (divorce, separation, alimony, child support)
3 Natural disasters (such as floods, hurricanes)
4 Death in the family
5 Addiction or dependency (drugs, alcohol, gambling)

### Employment Problems

6 Cutback in the number of hours worked
7 Laid off or fired from work
8 Your business failed
9 Business that employed you failed
10 Unable to work due to illness/accident
11 Lost second income

### Credit/Financial Problems

12 Bought too much on credit
13 Credit was too easy to get
14 Unable to get creditors to extend loans/ agree to different payment schedule
15 Creditors tried to collect their money
16 Sued by creditors
17 Wages actually garnished
18 Some property repossessed
19 Cosigned on a loan that wasn't paid
20 Cost of living went up
21 Anything else? (PLEASE SPECIFY)

## EXHIBIT 2

1 Threaten to repossess your personal property

2 Actually repossess your personal property

3 Seek to collect an unpaid balance after having repossessed some property

4 Threaten to foreclose on your home

5 Actually foreclose on your home

6 Threaten to garnish your wages

7 Actually garnish your wages

8 Telephone you frequently at home or work

9 Come to see you at home or work

10 Send you threatening letters

11 Contact a cosigner on a loan

12 Contact your employer

13 Contact a relative

14 Anything else? (PLEASE SPECIFY)

# EXHIBIT 3

1 Financial assets (bank accounts, stocks, bonds, CD's)
2 House or mobile home
3 Car
4 Truck
5 Recreational vehicle or motorcycle
6 Furniture or appliances
7 Jewelry, watch, or furs
8 Clothing
9 Land or investment property
10 Any Others? (PLEASE SPECIFY)

## EXHIBIT 4

| | | |
|---|---|---|
| MARITAL STATUS | 1 | MARRIED |
| | 2 | SEPARATED |
| | 3 | DIVORCED |
| | 4 | LIVING AS MARRIED |
| | 5 | SINGLE-NEVER MARRIED |
| | 6 | WIDOWED |
| AGE | 1 | Under 25 |
| | 2 | 25-34 |
| | 3 | 35-44 |
| | 4 | 45-54 |
| | 5 | 55-64 |
| | 6 | 65 or older |
| EDUCATION | 1 | Did not finish high school |
| | 2 | High school graduate |
| | 3 | Training or vocational school |
| | 4 | Attended college courses |
| | 5 | College graduate |
| | 6 | Advanced college degree |

## EXHIBIT 5

1 Student
2 Retired
3 Permanently disabled
4 Homemaker/care of children
5 Laid off/unable to find work
6 On strike
7 On sick leave
8 My business failed
9 Employer's business failed
10 OTHER (PLEASE SPECIFY)

## AUTHORIZATION FOR CREDIT REPORT

I/We, the undersigned, have voluntarily participated in an interview as part of a study of personal bankruptcy conducted by the Credit Research Center of Purdue University.

By signing this paper, I/we authorize the credit reporting agency (credit bureau) in my/our area to provide the Credit Research Center with my/our credit report(s) applicable to the time of my/our filing for bankruptcy.

This authorization is for the sole purpose of the bankruptcy study. My/Our understanding is that our name and address will be removed from the credit report and any data used in the study will be treated anonymously.

PLEASE PRINT:

YOUR FULL NAME: ______________________________

YOUR SOCIAL SECURITY NUMBER: ______________________

IF MARRIED:

YOUR SPOUSE'S NAME: ______________________________.

YOUR SPOUSE'S SOCIAL SECURITY NUMBER: ________________

ADDRESS: ______________________________

CITY: ______________ STATE: __________ ZIP CODE: ______

IF YOU HAVE LIVED AT THE ABOVE ADDRESS LESS THAN ONE YEAR, PLEASE FILL IN YOUR FORMER ADDRESS:

FORMER ADDRESS: ______________________________

CITY: ______________ STATE: __________ ZIP CODE: ______

PLEASE SIGN:

YOUR SIGNATURE: ______________________________

SPOUSE'S SIGNATURE: ___________________________

DATE: ______________________________

# APPENDIX C

## DATA RECORDED FROM CHAPTER 7 PETITION

33852

# CREDIT STUDY

## PETITION DATA SHEET

1 Petition Data of Debtor Interviewed **Before** Hearing → Yellow Form
2 Petition Data of Debtor Interviewed **After** Hearing → Yellow Form
3 Petition Data of Debtor Who Refused Interview → Blue Form

### COVER SHEET(S)

1. Respondent's Petition # (use last 5 numbers): __ __ __ __ __
(Also called bankruptcy, docket, file, proceeding, or case number)

2. Debtor (petitioner) is: 1 Individual 2 Husband/wife jointly

(Cover sheet may indicate "Individual" or "Joint" Petition or there will be boxes next to the words "individual" and "husband and wife as joint individuals" and the appropriate one will be checked to indicate an individual or joint petition)

3. Debtor's name and social security number (include both parties if joint petition):

Male: ______________________ Social Security #: ______________

Female: ______________________ Social Security #: ______________

4. Zip Code (of most recent address): __ __ __ __ __ __

5. Date filed (or executed on): ____/____/____
(Stamped or written in) Month Date Year

### STATEMENT PURSUANT TO RULE 219b OR DISCLOSURE OF COMPENSATION PAID OR PROMISED TO ATTORNEY

6. Legal services used: 1 Yes 2 No

(No "Rule 219b Statement" attached to petition implies no legal services used. Circle "2" and go on to #7.)

If Legal Services Used:

a. Total fee (paid and promised/due): $ ______________ 0 NR

b. Attorney's Name: ______________________

Address: ______________________

## STATEMENT OF FINANCIAL AFFAIRS

7. Specify which form used (heading across top of page or top right corner)

1 Statement of Financial Affairs for Debtor Not Engaged in Business → SKIP TO #12

2 Statement of Financial Affairs For Debtor Engaged in Business → GO TO #8

Debtor Engaged In Business ("2" circled on #7)

8. Prior bankruptcy
(probably item #7)
1 One or more prior bankruptcies listed
2 No other bankruptcies listed

9. Suits, executions, and attachments
(probably item 12)
Property attached, garnished, or seized (probably "c" in this section) 1 Yes 2 No 3 NR

10. Transfer of property
(probably item 14)
(1) Made one or more unusual gifts in year prior to bankruptcy (probably "a" in this section) 1 Yes 2 No 3 NR
(2) Made other transfer(s) (probably "b" in this section) 1 Yes 2 No 3 NR

11. Repossessions and returns
(probably item #13)
Any property returned to/repossessed by seller during year preceding bankruptcy 1 Yes 2 No 3 NR

→ SKIP TO #17

Debtor Not Engaged In Business ("1" Circled On #7)

12. Occupation and Income
(Probably item #2)

| | Total | RECORD HERE ALSO IF JOINT PETITION AND AMOUNTS SPECIFIED FOR BOTH PARTIES | |
|---|---|---|---|
| | | Male | Female |
| (1) Income from trade and profession (probably "d" in this Section) | | | |
| 1980 | $_____<br>0 None X NR | $_____<br>0 None X NR | $_____<br>0 None X NR |
| 1979 | $_____<br>0 None X NR | $_____<br>0 None X NR | $_____<br>0 None X NR |
| (2) Income from other sources (probably "e" in this Section) | | | |
| 1980 | $_____<br>0 None X NR | $_____<br>0 None X NR | $_____<br>0 None X NR |
| 1979 | $_____<br>0 None X NR | $_____<br>0 None X NR | $_____<br>0 None X NR |

13. Prior bankruptcy
(probably item #7)
1 One or more prior bankruptcies listed
2 No other bankruptcies listed

14. Suits, executions, and attachments
(probably item #10)
Property attached, garnished, or seized (probably "c" in this section) 1 Yes 2 No 3 NR

15. Transfer of property
(probably item #12)
(1) Made one or more unusual gifts in year prior to bankruptcy (probably "a" in this section) 1 Yes 2 No 3 NR
(2) Made other transfer(s) (probably "b" in this section) 1 Yes 2 No 3 NR

16. Repossessions and returns
(probably item #13)
Any property returned to/repossessed by seller during year [illegible] 1 Yes 2 No 3 NR

GO ON TO #17

## SCHEDULE A-2 CREDITORS HOLDING SECURITY

(Schedule A-2 is sometimes listed as a separate section or page. If so, include the requested information for all items in this section. Add up the "Market Value" and the "Amount of Claim" of all items listed (if no "totals" are shown) and record each of these totals in the spaces below.

If Schedules A-2 and A-3 are listed together, include below only those items checked as "secured." Include the totals only for the secured items.)

17. Total market value of all (secured) items listed $____________

18. Total claims of all (secured) items listed $____________

19. FOR EACH ITEM/TYPE OF SECURITY LISTED IN SCHEDULE A-2, SPECIFY:

| ITEM/TYPE OF SECURITY | WHEN INCURRED MONTH/YEAR | MARKET VALUE | AMOUNT OF CLAIM |
|---|---|---|---|
| 1 House (1st/only mortgage)*<br>0 No house listed | ___/___<br>0 NR | \$____<br>0 NR | \$____<br>0 NR |
| 2 Same house (2nd mortgage)<br>0 No second mortgage | ____<br>0 NR | \$____<br>0 NR | \$____<br>0 NR |

FOR ALL OTHER ITEMS LISTED IN SCHEDULE A-2, FILL IN GENERAL DESCRIPTION (E.G., CAR, BOAT, FURNITURE) IN THE SPACE BELOW AND COMPLETE THE REST OF THE INFORMATION:

| | | | |
|---|---|---|---|
| 3 ________ | ___/___<br>0 NR | \$____<br>0 NR | \$____<br>0 NR |
| 4 ________ | ___/___<br>0 NR | \$____<br>0 NR | \$____<br>0 NR |
| 5 ________ | ___/___<br>0 NR | \$____<br>0 NR | \$____<br>0 NR |
| 6 ________ | ___/___<br>0 NR | \$____<br>0 NR | \$____<br>0 NR |
| 7 ________ | ___/___<br>0 NR | \$____<br>0 NR | \$____<br>0 NR |
| 8 ________ | ___/___<br>0 NR | \$____<br>0 NR | \$____<br>0 NR |
| 9 ________ | ___/___<br>0 NR | \$____<br>0 NR | \$____<br>0 NR |

*(If there is more than one mortgage (creditor and claim) on the same house and no distinction is made as to which is first or second mortgage, assume that the "first" mortgage is the older (earlier date on when incurred) one. If no dates are given, assume that the larger amount is the "first" mortgage.

#19 (Continued) Schedule A-2

| ITEM/TYPE OF SECURITY | WHEN INCURRED | MARKET VALUE | AMOUNT OF CLAIM |
|---|---|---|---|
| 10 ____________ | ____/____<br>0 NR | $____________<br>0 NR | $____________<br>0 NR |
| 11 ____________ | ____/____<br>0 NR | $____________<br>0 NR | $____________<br>0 NR |
| 12 ____________ | ____/____<br>0 NR | $____________<br>0 NR | $____________<br>0 NR |
| 13 ____________ | ____/____<br>0 NR | $____________<br>0 NR | $____________<br>0 NR |
| 14 ____________ | ____/____<br>0 NR | $____________<br>0 NR | $____________<br>0 NR |
| 15 ____________ | ____/____<br>0 NR | $____________<br>0 NR | $____________<br>0 NR |
| 16 ____________ | ____/____<br>0 NR | $____________<br>0 NR | $____________<br>0 NR |
| 17 ____________ | ____/____<br>0 NR | $____________<br>0 NR | $____________<br>0 NR |
| 18 ____________ | ____/____<br>0 NR | $____________<br>0 NR | $____________<br>0 NR |
| 19 ____________ | ____/____<br>0 NR | $____________<br>0 NR | $____________<br>0 NR |
| 20 ____________ | ____/____<br>0 NR | $____________<br>0 NR | $____________<br>0 NR |
| 21 ____________ | ____/____<br>0 NR | $____________<br>0 NR | $____________<br>0 NR |
| 22 ____________ | ____/____<br>0 NR | $____________<br>0 NR | $____________<br>0 NR |
| 23 ____________ | ____/____<br>0 NR | $____________<br>0 NR | $____________<br>0 NR |
| 24 ____________ | ____/____<br>0 NR | $____________<br>0 NR | $____________<br>0 NR |
| 25 ____________ | ____/____<br>0 NR | $____________<br>0 NR | $____________<br>0 NR |
| 26 ____________ | ____/____<br>0 NR | $____________<br>0 NR | $____________<br>0 NR |

## SCHEDULE A-3 CREDITORS HAVING UNSECURED CLAIMS WITHOUT PRIORITY

(If Schedule A-3 is listed as a separate section or page, include the requested information for all items included in this section. Add up the "Amount of Claim" of all items listed (if no "total" is shown) and record the total in the space below. (Note: Page may be called "Listing of Creditors.")

If Schedule A-3 is listed with Schedule A-2, include below only those items checked as "unsecured." Include the total only for the unsecured items.

20. Total claims of all (unsecured) items listed $ ____________

CREDITOR CODES:

| | | |
|---|---|---|
| 1 Bank | 4 Finance or Loan Company | 8 Friend or Relative or Co-worker |
| 2 Savings & Loan or Mortgage Company | 5 Retailer (Store) | 9 Other/Not Sure of Type (SPECIFY NAME IN SPACE) |
| 3 Credit Union | 6 Dealer or Contractor | |
| | 7 Doctor or Hospital | |

21. FOR EACH CREDITOR LISTED IN SCHEDULE A-3, CIRCLE APPROPRIATE CREDITOR CODE AND FILL IN AMOUNT OF CLAIM

| | CREDITOR CODE | AMOUNT OF CLAIM |
|---|---|---|
| #1 | 1 2 3 4 5 6 7 8 9 (SPECIFY BELOW)<br>____________ | $ ____________ |
| #2 | 1 2 3 4 5 6 7 8 9 (SPECIFY BELOW)<br>____________ | $ ____________ |
| #3 | 1 2 3 4 5 6 7 8 9 (SPECIFY BELOW)<br>____________ | $ ____________ |
| #4 | 1 2 3 4 5 6 7 8 9 (SPECIFY BELOW)<br>____________ | $ ____________ |
| #5 | 1 2 3 4 5 6 7 8 9 (SPECIFY BELOW)<br>____________ | $ ____________ |
| #6 | 1 2 3 4 5 6 7 8 9 (SPECIFY BELOW)<br>____________ | $ ____________ |
| #7 | 1 2 3 4 5 6 7 8 9 (SPECIFY BELOW)<br>____________ | $ ____________ |

#21 (Continued) Schedule A-3

| | CREDITOR CODE | AMOUNT OF CLAIM |
|---|---|---|
| #8 | 1 2 3 4 5 6 7 8 9 (SPECIFY BELOW)<br>________ | $ ________ |
| #9 | 1 2 3 4 5 6 7 8 9 (SPECIFY BELOW)<br>________ | $ ________ |
| #10 | 1 2 3 4 5 6 7 8 9 (SPECIFY BELOW)<br>________ | $ ________ |
| #11 | 1 2 3 4 5 6 7 8 9 (SPECIFY BELOW)<br>________ | $ ________ |
| #12 | 1 2 3 4 5 6 7 8 9 (SPECIFY BELOW)<br>________ | $ ________ |
| #13 | 1 2 3 4 5 6 7 8 9 (SPECIFY BELOW)<br>________ | $ ________ |
| #14 | 1 2 3 4 5 6 7 8 9 (SPECIFY BELOW)<br>________ | $ ________ |
| #15 | 1 2 3 4 5 6 7 8 9 (SPECIFY BELOW)<br>________ | $ ________ |
| #16 | 1 2 3 4 5 6 7 8 9 (SPECIFY BELOW)<br>________ | $ ________ |
| #17 | 1 2 3 4 5 6 7 8 9 (SPECIFY BELOW)<br>________ | $ ________ |
| #18 | 1 2 3 4 5 6 7 8 9 (SPECIFY BELOW)<br>________ | $ ________ |

SCHEDULE B-1 REAL PROPERTY

22. Market value of each house listed:

$ ____________ $ ____________ $ ____________

0 No house(s) listed

EXEMPTION ELECTION (Located Between Schedules B-3 and B-4)

23. The debtor(s) elects to . . . exempt(ions) pursuant to (Circle item(s) checked)

1 Federal Exemption 11 U.S.C. 522
2 State Exemption (laws of the State ____________)
3 Both
4 NR

SCHEDULE B-4 PROPERTY CLAIMED AS EXEMPT

24. Value claimed exempt -- total $ ____________

(If no total amount is shown, add up the value claimed exempt for each item listed in B-4)

0 NONE X NR

SUMMARY OF DEBTS AND PROPERTY

25. A-2 Secured claims $ ____________ 0 NONE

26. A-3 Unsecured claims without priority $ ____________ 0 NONE

27. Schedule A Total $ ____________ 0 NONE

28. B-1 Real property (total value) $ ____________ 0 NONE

29. Schedule B Total $ ____________ 0 NONE

30. Does Schedule B Total include item listings for B-1, B-2, B-3 and B-4 or isn't the B-4 item included in (above) the Schedule B Total line?

1 B-4 Is included in total
2 B-4 Is not included

## PUBLICATIONS
## CREDIT RESEARCH CENTER

MONOGRAPH No. 1: An Empirical Analysis of Retail Revolving Credit
MONOGRAPH No. 2: Credit Policies and Store Locations in Arkansas Border Cities: Merchant Reactions to a Ten Percent Finance Charge Ceiling
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MONOGRAPH No. 4: An Economic Report on Consumer Lending in Texas
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WORKING PAPER No. 19: Testing for Sex Discrimination in Commercial Bank Consumer Lending
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REPRINT No. 15: Robert W. Johnson and A. Charlene Sullivan, "Segmentation of the Consumer Loan Market," *Journal of Retail Banking,* Vol. III, No. 3, September 1981.

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# VOLUME II
## Personal Bankruptcy: Causes, Costs and Benefits

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# CONSUMER BANKRUPTCY STUDY

## VOLUME II

## Personal Bankruptcy: Causes, Costs and Benefits

A. Charlene Sullivan

CREDIT RESEARCH CENTER

1982

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# PREFACE

This study had been prepared by the staff of the Credit Research Center (CRC) in cooperation with Arthur D. Little, Inc. (ADL) and Opinion Research Corporation (ORC). The study was financed by the Coalition for Bankruptcy Reform, a group made up of a broad cross section of the consumer credit industry and associated organizations. About five-sixths of the funding was used to cover the costs of the field survey of consumers filing for Chapter 7 in 20 judicial districts in ten states. The remaining one-sixth was provided to CRC to help defray the incremental costs of preparing the study. The Credit Research Center is within the Krannert Graduate School of Management, Purdue University.

When a study is funded by an industry group, one must be prepared to hear charges of bias "in favor of" the industry. Such charges are, of course, based on a false premise that what is good for the industry is bad for consumers and vice versa. As we have shown in this and a number of earlier research studies, issues of public policy in the areas of consumer and mortgage credit involve trade-offs--more accurately, subsidies or wealth transfers--between one group of consumers and another. In this competitive market, one could not bias a study "in favor of" the credit industry *per se*, even if that were the objective.

Nonetheless, the research was structured in a manner to avoid potential bias, or the taint of bias. The questionnaire to be administered to debtors was prepared by three members of the CRC staff: Robert W. Johnson, Richard L. Peterson, and A. Charlene Sullivan. That and subsequent drafts were modified on the basis of suggestions from Dr. Edwin B. Cox and Blair C. Shick of ADL and Sandra M. Spies of ORC. Nobody from the credit industry or associated organizations saw the questionnaire until after it was in the field.

Edwin Cox and Blair Shick of ADL had prime responsibility for designing the sampling plan, both in the selection of the states and judicial districts and in the procedures to follow in selecting consumers to be interviewed. They also had the task of gaining the cooperation of the judges in each of the districts and that of the attorneys appearing in the courts. CRC staff had no contact with any of the many judges who cooperated in this research effort.

The interviewing of the debtors and the gathering of data from the petition was the sole responsibility of the staff of ORC. The important functions of coding and tabulating the data were entirely the duty of ORC staff. The raw data in the form of the questionnaires and petition data forms remain in Princeton with ORC, both to separate the data gathering and data analysis functions and to protect the privacy of the consumers interviewed.

The analysis of the data was the responsibility of the staff of CRC. ORC provided us with a computer tape encoded with the data on the 1,199 cases sampled. With the aid of able graduate research assistants (Swaminathan G. Badrinath and Dan A. Black) we prepared the tables provided in this and the following monograph, as well as many supplementary tables used in the analysis of the data. Members of the credit industry had no part in this analysis, nor did any of the CRC staff have a role in drafting or reviewing the proposed amendments to the Bankruptcy Act of 1978 proposed by the Coalition.

This study does not relate to changes in bankruptcy legislation introduced by the Bankruptcy Act of 1978. Instead, this study provides an empirical investigation and analysis of a public policy established in 1898 under the Bankruptcy Act passed in that year. At that time Congress decided that consumers could file for bankruptcy without regard to their ability to pay some portion of their debts out of future income. That policy has remained essentially unchanged since that time. Whether that is a sound policy in the very different credit markets of 1982 is a value judgment. The empirical data and analysis provided in this monograph provide a basis of reaching that value judgment.

We are greatly indebted for the highly professional and constructive contributions of Ed Cox and Blair Shick at ADL and Sandy Spies and Carole Hewitson of ORC. Not only are they experts at what they do, but they are delightful to work with. We also thank our secretarial staff--Marty Lynch, Cindy Overman and Betty Schoenhals for their skills and patience. Finally we thank each other for carefully reviewing and editing the numerous drafts of each of the chapters.

Robert W. Johnson
Richard L. Peterson
A. Charlene Sullivan

# PERSONAL BANKRUPTCY

## CAUSES, COSTS, AND BENEFITS

A. Charlene Sullivan*

## Abstract

The option to use the court system as a means of reducing one's debts is available to all consumers.[1] Whether a consumer exercises that option is a function of the expected benefit (reduction in debts) relative to the expected costs of bankruptcy (loss of assets, reduced access to credit markets, transactions costs). This monograph, the second of two monographs prepared for the Consumer Bankruptcy Study by the Credit Research Center, contains an analysis of a sample of households who had petitioned for a straight liquidation of debts under Chapter 7 of the Bankruptcy Act. Included in Chapter 1 of the monograph is a comparison of the study sample with a national sample of households who used consumer instalment credit. This comparison allows us to identify the distinguishing demographic and economic characteristics of the sample of petitioners. In the second chapter we trace the most traveled paths to bankruptcy and evaluate the role played by unemployment, personal problems, and creditor actions as causes of bankruptcy. In addition, alternatives to bankruptcy the petitioners were familiar with or had

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*Senior Research Scholar, Credit Research Center, Purdue University. This monograph was prepared with the assistance of S. Badrinath. Debra A. Drecnik, Robert W. Johnson and Richard L. Peterson provided helpful suggestions.

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tried and their sources of information about the bankruptcy process are evaluated. The controversial role played by lawyer advertising of bankruptcy services is given particular attention. In Chapter 3, petitioners' evaluations of some of the expected costs of bankruptcy are summarized. Included in those costs are their expected loss of assets and future ability to obtain credit. The benefits gained from taking a straight liquidation bankruptcy are equal to the change in the household's net worth resulting from the write-down of liabilities and loss of assets. In Chapter 3, this benefit of bankruptcy is calculated for each petitioner and analyzed to determine the characteristics of petitioners receiving the greatest benefits from bankruptcy. In Chapter 4, the cross-sectional relationship between the total value of assets exempted from liquidation in a bankruptcy as specified by state or federal law and the characteristics of households petitioning for bankruptcy is examined to address the question of whether the level of exemptions has any effect on the number and characteristics of persons expected to file for bankruptcy. In addition, there is considerable variation across bankruptcy court districts in terms of the incidence of liquidation bankruptcy relative to reorganizations (Chapter 13). We selected the eight court districts in our sample that were on the extreme ends of the continuum of the proportion of personal bankruptcies that were Chapter 7. We analyze the characteristics of petitioners from those court districts where the proportion of Chapter 7 cases was lowest relative to those where the proportion of Chapter 7s was highest to determine the effect of the judge on the bankruptcy phenomenon.

Finally, legislation has been proposed which would require that a straight liquidation bankruptcy be available only to those consumers who could not repay a reasonable portion of their debts out of anticipated future income. A consumer seeking relief from debts could obtain court protection from creditors under Chapter 13 of the Bankruptcy Act and repay outstanding debts over a specified period according to a schedule approved by the bankruptcy judge. Otherwise, the consumer could renegotiate payments with creditors or seek the assistance of a credit counseling agency. In Chapter 5, the characteristics of petitioners in our sample who would have been denied bankruptcy under the conditions of the proposed legislation are examined.

This study was not designed or intended to measure directly the extent to which the rapid increase in the number of personal bankruptcies since 1980 could be attributed to the changes made in The Bankruptcy Reform Act of 1978 and put into effect in October 1979. However, the study was intended to show how the decision to file personal bankruptcy is reached and how the specifics of the law governing the process affect that decision. The results of this study suggest that the incidence of personal bankruptcies can be linked with facets of the new bankruptcy law that reduced the expected cost of bankruptcy, especially for middle and upper-income families.

# CHAPTER 1

# PROFILE OF THE PETITIONER FOR PERSONAL BANKRUPTCY

## I. Overview

A creditor must estimate the probability of default or bankruptcy for a particular consumer or group of consumers in order to price credit correctly. That estimation is typically facilitated by comparisons of the characteristics of proven good and bad credit customers. Differences in demographic and economic characteristics of the two groups of customers are used to assess the credit quality of new applicants for credit. Using this practice as a basis, we compared the characteristics of the sample of petitioners for debtor relief (called the petitioner sample) with the characteristics of a national sample of households with consumer debt outstanding (called the debtor sample). The national survey data were collected in 1977 in a survey of consumers' views on consumer credit.[2] To make comparisons of dollar values in the following analysis, the 1977 data were adjusted to reflect price level changes that had occurred between 1977 and 1981.[3] In the following sections we highlight the differences in the demographic and economic characteristics of the two groups.

## II. Demographic Characteristics

### A. Position in the Life Cycle

Past studies of consumers' use of nonmortgage instalment credit have shown a relationship between a household's position in the life cycle and the amount of consumer debt the household will have outstanding. Young families have a greater demand for credit than mature families because family income is generally low during the family-formation years. Also, young heads of household have less job security and are more vulnerable to layoffs in periods of unemployment. In addition, they have fewer financial assets and are less able to handle unexpected expenses. Thus, one would expect the incidence of bankruptcy to be high among young families with small children. The life cycle characteristics of the petitioner and debtor samples are shown in Exhibit 1-1.

The distributions of the two groups classified by position in the life cycle were significantly different at the ten percent level of confidence. The petitioner sample was made up primarily of families with a head of household younger than 45 years of age. Relatively more of the petitioners than the debtor sample were young and married with young children. Relative to the petitioners, the debtors were more likely to be 45 years old or older, married and with no children at home. Thus, as expected, the consumers who get into financial distress are most likely to be in the early stages of the life-cycle when their need for credit is highest. Almost 30 percent of the petitioners were single, with or without children. Only 15 percent of debtors were in this category.

## B. Age

The petitioner head of household was most likely to be between the ages of 25 and 34 (Exhibit 1-2). Approximately 21 percent of both the petitioner and the debtor samples were younger than 25 years old. Only about seven percent of the petitioners were 55 years old or older in contrast to about 22 percent of the debtor sample. The petitioner head of household was almost twice as likely as the debtor head of household to be between the ages of 25 and 34. Petitioners and debtors under 25 years of age occurred with almost identical frequency.

## EXHIBIT 1-1

## POSITION IN LIFE CYCLE

| | 1981 Bankruptcy Study* | | 1977 Consumer Credit Survey** | |
|---|---|---|---|---|
| Less than 45 yrs. old | | 69.5% | | 52.9% |
| Single - no children | 14.9% | | 7.9% | |
| Married | | | | |
| No children | 11.3 | | 10.1 | |
| Children <6 yrs. old | 29.1 | | 21.3 | |
| Children >6 yrs. old | 14.2 | | 13.6 | |
| 45 yrs. old or older | | 14.4 | | 36.7 |
| Single - no children | 3.2 | | 6.1 | |
| Married | | | | |
| No children | 5.0 | | 17.9 | |
| Children | 6.2 | | 12.7 | |
| Single (any age) with children | 14.8 | 14.8 | 6.9 | 6.9 |
| Missing | 1.3 | 1.3 | 3.3 | 3.3 |
| Total | | 100.0% | | 100.0% |

$\chi^2$ = 232.67 Significant at the ten percent level of confidence.

---

*Based on 1199 respondents who had filed for bankruptcy under Chapter 7.

**Based on 1524 respondents who had positive amounts of instalment or credit card debt.

Totals may not add to 100 percent due to rounding.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study; 1977 Consumer Credit Survey, Board of Governors of the Federal Reserve System.

NOTE: The chi-square statistic is based on a comparison of the overall distributions of life cycle characteristics not on the summary tables in the right most column for each sample.

## EXHIBIT 1-2

## AGE OF HEAD OF HOUSEHOLD

| | 1981 Bankruptcy Study | 1977 Consumer Credit Survey |
|---|---|---|
| Under 25 years | 12.3% | 12.2% |
| 25 - 34 | 45.0 | 26.0 |
| 35 - 44 | 24.5 | 20.1 |
| 45 - 54 | 11.0 | 19.2 |
| 55 - 64 | 5.2 | 15.1 |
| 65 or older | 1.2 | 6.9 |
| No response | .8 | .4 |
| | 100.0% | 100.0% |

$\chi^2 = 250.80$ Significant at the ten percent level of confidence.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study; 1977 Consumer Credit Survey, Board of Governors of the Federal Reserve System.

Almost half of the petitioner sample were in the 25-34 age bracket. It is likely that, due to the baby boom, a greater percentage of debtors in general fall in that age category today than is shown by the 1977 survey data.

### C. Marital Status

More than half of the petitioners for bankruptcy were married (Exhibit 1-3) or living as married. This is in contrast to the debtor sample where 74 percent were married. Almost 30 percent of the petitioner sample were divorced or separated and 11 percent reported that they had never been married.

The Bankruptcy Act of 1979 made it possible for a husband and wife to file for bankruptcy jointly and double the asset exemptions allowed in some states. An analysis of the petitioners' filing status relative to marital status revealed that 71 percent of the petitioners married, separated or living as married filed for joint bankruptcy. Thus, 47.6 percent of the sample of petitioners were filing a joint petition. Twenty-two percent of married petitioners reported that the spouse had not filed for bankruptcy.

### D. Education

There were striking differences in the level of education for the two groups of consumers (Exhibit 1-4). Although there was little difference in the percentage of each group which had not finished high school, a head of household in the petitioner sample was much more likely to have terminated his or her education after completing high school than a member of the debtor sample. Nineteen percent of debtor heads of

## EXHIBIT 1-3

## MARITAL STATUS

| | 1981 Bankruptcy Study | 1977 Consumer Credit Survey |
|---|---|---|
| Married | 57.1 | 74% |
| Separated | 8.5 | |
| Divorced | 20.3 | |
| Living as married | 1.4 | |
| Single - never married | 10.9 | |
| Widowed | 1.8 | |
| Other | | 26* |
| | 100.0% | 100% |

### PETITIONERS' FILING STATUS - MARITAL STATUS

| | |
|---|---|
| Joint filing (married, separated, or living as married) | 47.6% |
| Individual filed, spouse filed | 1.6 |
| Individual filed, spouse did not file | 14.9 |
| Individual filing, no spouse | 35.9 |
| | 100.0% |

---

*In the 1977 Consumer Credit Survey, respondents were asked to indicate whether they were married or not. No further information on marital status was obtained.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study; 1977 Consumer Credit Survey, Board of Governors of the Federal Reserve System.

## EXHIBIT 1-4

## EDUCATION OF HEAD OF HOUSEHOLD

| | 1981 Bankruptcy Study | 1977 Consumer Credit Survey |
|---|---|---|
| Did not finish high school | 24.5% | 22.9% |
| High school graduate | 32.3 | 17.8 |
| Training or vocational school | 7.6 | 19.0 |
| Attended college courses | 23.7 | 19.1 |
| College graduate | 6.8 | 15.0 |
| Advanced college degree | 2.8 | 5.5 |
| No response | 2.3 | .7 |
| | 100.0% | 100.0% |

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study; 1977 Consumer Credit Survey, Board of Governors of the Federal Reserve System.

household had completed vocational or training school compared to less than eight percent of petitioners. Both groups had a large contingent that attended some college courses but relatively few in the petitioner sample had completed a bachelor's degree or an advanced degree.

## E. Employment

The number of individuals filing for personal bankruptcy has historically been highly correlated with the rate of unemployment. Thus, one would expect that a large percentage of the petitioner households had suffered from an interruption in employment. However, the figures in Exhibit 1-5 indicate that 78.6 percent of petitions had been filed by households that had at least one person employed full time at the time of filing. In addition, 58.5 percent of petitioners had at least one person in the household employed continuously for the 12 months prior to filing for bankruptcy. Those households filing for joint bankruptcy were more likely to have at least one person working full time at the time of filing than those filing singly. Almost 22 percent of petitioners for joint bankruptcy had two people working full time at the time of filing. At the time the petition was filed, 72 percent of male petitioners held full time jobs and 20 percent were unemployed. Forty-one percent of female petitioners held full time jobs and 45 percent were unemployed. Male respondents who were unemployed were most likely to have been laid off or permanently disabled. Female respondents who were unemployed were most likely to have been staying at home to care for family.

The distributions of occupations for the two groups (Exhibit 1-6) show that the petitioners were considerably more likely, relative to

EXHIBIT 1-5

EMPLOYMENT STATUS OF BANKRUPT CONSUMERS

| Type of Petition | | One Person Employed Full-Time | Two People Employed Full-Time | At Least One Person Employed Full-Time |
|---|---|---|---|---|
| Single Filing | 626 | 471(75.2%) | xxxx | 471(75.2%) |
| Joint Filing | 571 | 345(60.4%) | 124(21.7%) | 469(82.1%) |
| Unknown | 2 | ? | ? | 2(100%) |
| Total | 1199 | | | 924(78.6%) |

NOTE: Number of Petitions with at least one person employed continuously for the preceding 12 months 702 (58.5%).

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study, Monograph 23, Chapter 3, p. 33.

## EXHIBIT 1-6

## OCCUPATION - HEAD OF HOUSEHOLD

| | 1981 Bankruptcy Study | 1977 Consumer Credit Survey |
|---|---|---|
| Professional & Technical | 7.7% | 12.4% |
| Managerial Officials or Proprietor | 7.3 | 14.4 |
| Clerical | 8.3 | 5.9 |
| Sales | 5.2 | 4.2 |
| Craftsmen, Foremen | 19.7 | 18.7 |
| Operatives[1] | 9.1 | 13.9 |
| Service Workers[2] | 11.1 | 4.7 |
| Laborers[3] | 9.5 | 5.1 |
| Other (NA) | 1.9 | 5.1 |
| No response | 20.3 | 15.6 |
| | 100.0% | 100.0% |

[1] Operatives: apprentices; auto service and parking attendants; railroad brakemen; bus drivers; bus and street railway conductors; dyers; motormen; sailors and deck hands; stationary foremen; taxicab drivers; truck and tractor drivers; welders.

[2] Service Workers: housekeepers, private household; laundresses, private household; hospital and other institutions attendants; barbers; beauticians, and manicurists; bartenders; cooks; elevator operators; foremen, fire protection; guards, watchmen, and doorkeepers; janitors; marshals and constables; policemen and detectives; porters; ushers; waiters and waitresses; crossing watchmen.

[3] Laborers: fishermen, garage laborers and car washers and greasers; gardeners, groundkeepers, farmers, longshoremen and stevedores; lumbermen and woodchoppers.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study; 1977 Consumer Credit Survey, Board of Governors of the Federal Reserve System.

the sample of debtors, to hold unskilled jobs (service, laborer). The debtors were more likely to hold professional or managerial positions than the petitioners.

In general, the data do not indicate that the petitioner sample suffered from a high level of unemployment. Most of the petitioner heads of household held unskilled jobs and about one-fifth of the bankruptcy petitions came from two-income families.

### F. Home Ownership

As one might expect from the age distribution of the petitioners, few in that sample owned their home (Exhibit 1-7). Twenty-seven percent owned their residence and ten percent neither owned nor rented but were living with family members, or others. The reamining petitioners were renters. In contrast to the debtor sample, the petitioners were far less likely to own their home and much more likely to rent. The market values of the principal residence owned by the petitioners ranged from $495 to $18,000 (Exhibit 1-8). The average market value of $34,550.

All of the petitioners had mortgages on their principal residence. A large percentage (38 percent) had mortgages (first and second where applicable) that totaled less than 50 percent of the market value at the time they filed for bankruptcy (Exhibit 1-9). However, almost ten percent reported a loan-to-value ratio of greater than 100 percent. Although this result could be attributable to reporting errors on the petition, it could also be explained by under-valuation of the asset or to a real decline in the market prices of their housing. The fact that mortgage debt obligations were greater than the value of the property may have motivated the bankruptcy for this group of petitioners. The

## EXHIBIT 1-7

## HOME OWNERSHIP

| | 1981 Bankruptcy Study | 1977 Consumer Credit Survey |
|---|---|---|
| Own home | 27% | 72% |
| Rent | 63 | 25 |
| Neither | 10 | 3 |
| No response | - | - |
| | 100% | 100% |

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study; 1977 Consumer Credit Survey, Board of Governors of the Federal Reserve System.

## EXHIBIT 1-8

## REAL ESTATE VALUE

## (FOR 319 HOMEOWNERS)

| Market Value of Principal Residence | Number | Percent |
|---|---|---|
| $495-15,000 | 71 | 22% |
| $15,001-30,000 | 101 | 32 |
| $30,001-60,000 | 107 | 34 |
| $60,001-90,000 | 23 | 7 |
| $90,001-120,000 | 7 | 2 |
| $120,001-180,000 | 7 | 3 |
| Missing | 3 | - |
| | 319 | 100% |

NOTE: Average value = $34,550

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

## EXHIBIT 1-9

## MORTGAGE ON PRINCIPAL RESIDENCE

## (FOR 319 HOMEOWNERS)

| Mortgage Debt (including second mortgage) to Market Value | Number | Percent |
|---|---|---|
| Less than 50 percent | 120 | 38% |
| 50-60 percent | 15 | 5 |
| 61-70 percent | 21 | 7 |
| 71-80 percent | 31 | 10 |
| 81-90 percent | 26 | 8 |
| 91-100 percent | 42 | 13 |
| Greater than 100 percent | 29 | 9 |
| Business bankruptcies | 33 | 10 |
| Missing values | 2 | — |
|  | 319 | 100% |

NOTE: Average total mortgage credit outstanding for nonbusiness bankruptcies = $22,189.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

average mortgage outstanding was $22,890 and the average loan-to-value ratio was about 66 percent.

Slightly more than 25 percent of the petitioners filing a nonbusiness bankruptcy who owned their principal residence reported that they had a second mortgage. The average dollar value reported for the second mortgages was $15,123. The smallest second mortgage reported was $680 and the largest was $69,000.

The average mortgage payment for those petitioners who owned their home was slightly more than $230 per month (as was the average rental payment). This is a low monthly payment in contrast to that required on a new mortgage today. Thus, that factor did not seem to be a significant factor causing these families to take bankruptcy. Those who reported separate monthly utility expenses including heat, telephone and electricity had an average monthly utility bill of $170.

It is noteworthy that so few of the petitioners relative to debtors in general owned their own home. Home ownership is an important indicator of creditworthiness to financial institutions. Perhaps petitioners in general were perceived by financial institutions as high risk because of the lack of homeownership. Consequently, credit from these sources was limited and they resorted to the use of credit from sellers of goods and services who may not check credit reports or report to credit bureaus and take collateral. Thus, when these consumers did not strictly discipline themselves in terms of their use of credit, they got little feedback from the credit markets until they had become overextended. This path to bankruptcy will be evaluated further in Chapter 3.

## EXHIBIT 1-10

## ANNUAL BEFORE-TAX FAMILY INCOME

| | 1981 Bankruptcy Study | 1977 Consumer Credit Survey* |
|---|---|---|
| Less than $5,000 | 19.8% | 2.4% |
| $5,000 - 9,999 | 29.7 | 11.3 |
| $10,000 - 14,999 | 24.7 | 9.3 |
| $15,000 - 19,999 | 11.2 | 10.4 |
| $20,000 or more | 14.7 | 66.6 |
| | 100.0% | 100.0% |

*Adjusted for cost of living increase from 1977 to 1981.

$X^2 = 831.79$ Significant at the ten percent level of confidence.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study; 1977 Consumer Credit Survey, Board of Governors of the Federal Reserve System.

## III. Family Income

The average before-tax family income reported by the petitioners was about $10,400.[4] Although the bulk of the petitioners reported that at least one person in the household was employed at the time of the filing, more than 40 percent of petitioners made less than $10,000 in before-tax income (Exhibit 1-10). Only about 15 percent of the petitioner sample had family income of more than $20,000. Almost 20 percent of the petitioner sample reported annual family income of less than $5,000. Fourteen percent of the sample reported that they had received food stamps valued at an average of $126 in the month before filing for bankruptcy

In sharp contrast, the bulk of the debtor sample (67 percent) made more than $20,000 before taxes per year (adjusted for inflation since the time of the 1977 survey). Only 14 percent made less than $10,000 and only about two percent made less than $5,000 per year before taxes. The distributions of the two groups by income category were significantly different at the ten percent level of confidence.

Although the average income of the petitioner sample was very low, the petitioners were generally optimistic about their income prospects. Fifty percent expected their income to increase by the end of the year from its level at the time of the filing and 35 percent expected their income to remain about the same throughout the year. Twenty-two percent expected their income to increase by more than ten percent.

## IV. Summary

This analysis of the demographic and economic characteristics of the petitioner sample indicates that the petitioners were primarily heads of household of young families. The head of the petitioner household was most likely to have a high school degree, be employed in an unskilled labor position, and report family income of $5,000 to $10,000 per year. At the time of the filing the bulk of petitioner households had at least one person employed full time and expected family income to increase in the year following their filing date. Less than 30 percent of the petitioners owned their own home. Almost 15 percent had received food stamps in the month before they petitioned for bankruptcy.

In contrast to the national sample of users of consumer instalment credit, the petitioners were younger, and were less likely to be married at the time they filed for bankruptcy. Most were in the prime family formation years. In addition, the petitioners were more likely to have stopped their formal education after high school and hold an unskilled position. The petitioners were much less likely to own their homes than the debtors and reported significantly less in terms of before-tax family income.

# FOOTNOTES

[1] The option can be lawfully exercised only once within a six year period.

[2] See Durkin and Elliehausen (1978) for a complete description of the data from the survey. The data used here represent the subset of participants in the national survey who had outstanding instalment or revolving credit at the time of the survey.

[3] The change in the Consumer Price Index (CPI) was used to make the price level adjustments.

[4] One hundred and twenty-nine cases did not report an income figure. The average is based on those people who did report a reasonable income figure. Zero income was considered reasonable in some cases (See Monograph 23, Cahpter 3).

# CHAPTER 2

# THE ROUTE TO BANKRUPTCY

## I. Overview

Given the cost of personal bankruptcy it may be desirable to reduce its incidence.[1] In order to do that, outside of decreasing the attractiveness of the bankruptcy option through legislation, one should have an understanding of how consumers get into financial distress. A major objective of this study was to analyze the alternate paths to bankruptcy taken by the households in our sample. In this chapter, we examine the petitioners' debt burden, the sources of consumer credit used, the petitioners' perceptions of the events that triggered their bankruptcy and the information sources used by the petitioners in their search for a solution to their financial problems.

## II. Petitioners' Use of Nonmortgage Debt

In the market for business loans, the firm's ability to obtain additional credit and the terms of that credit are determined by bond rating systems or creditors' analysis of financial statements that in many cases have been audited and certified by independent third parties. In the market for consumer credit there are guidelines used by practitioners that suggest that a family's total monthly debt payments should be no more than a certain percentage of monthly income. An alternative rule says that a family that borrows from one source to repay another source within a month is using too much debt. However, consumers do not prepare audited financial statements. Consequently, creditors considering consumer loan applications, in most cases, may not have complete information about the true financial status of the applicants and cannot restrict the borrowers' subsequent use of credit from other creditors.[2] Thus, each individual household has the responsibility to discipline its own use of credit to that amount that is manageable, in light of the stability of family income, sources of emergency funds, attitudes toward risk and other factors.

## A. Amount of Nonmortgage Debt

The average amount of nonmortgage, nonbusiness instalment credit in the portfolios of the petitioners was about $19,000. The distribution of nonmortgage debt outstanding for the petitioner sample is shown in Exhibit 2-1. Only 2.1 percent of the petitioners had less than $2,000 in nonmortgage debt outstanding at the time of the filing. Seventeen cases (less than two percent) had $500 or less in debts outstanding at the time of the filing. Eighty-three percent of the petitioner group had more than $5,000 in nonmortgage instalment debt outstanding.

The average (adjusted for changes in the cost of living) consumer debt outstanding for the debtor sample was about $3,000. Almost 20 percent had less than $500 in debt outstanding and only 36.2 percent owed more than $5,000 in consumer credit. Thus, it is clear that the petitioners' use of consumer credit differed sharply from that of the debtor sample.

The ratio of consumer credit outstanding relative to before-tax family income may be used as an indicator of the financial strength of a household.[3] The distributions of this ratio for the two samples are shown in Exhibit 2-2.

## EXHIBIT 2-1

## NONMORTGAGE INSTALMENT DEBT OUTSTANDING

## (INCLUDING CREDIT CARD OUTSTANDINGS)

| | 1981 Bankruptcy Study | 1977 Consumer Credit Survey* |
|---|---|---|
| $1-199 | 1.1% | 11.0% |
| $200-499 | .3 | 8.2 |
| $500-999 | .2 | 9.6 |
| $1000-1999 | .5 | 13.5 |
| $2000 and more | 97.9 | 57.8 |
| $2000-2999 | 2.6 | 8.3 |
| $3000-3999 | 5.6 | 6.6 |
| $4000-4999 | 6.3 | 6.7 |
| $5000 and more | 83.4 | 36.2 |
| | 100.0% | 100.0% |

*Adjusted for price level change between 1977 and 1981.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study; 1977 Consumer Credit Survey, Board of Governors of the Federal Reserve System.

## EXHIBIT 2-2

## TOTAL INSTALMENT DEBT TO PRE-TAX ANNUAL FAMILY INCOME

| Percent of Instalment Debt to Pre-tax Income | 1981 Bankruptcy Study | 1977 Consumer Credit Survey |
|---|---|---|
| 1-25% | 5.2% | 61.7% |
| 26-50% | 12.6 | 16.5 |
| 51-75% | 17.6 | 5.4 |
| 76-100% | 10.9 | 2.8 |
| More than 100% | 44.9 | 13.6 |
| Not ascertained | 8.7 | |
| | 100.0% | 100.0% |

SOURCE: Credit Research Center, Purdue University. Consumer Bankruptcy Study, 1977 Consumer Credit Survey, Board of Governors of the Federal Reserve System.

Only 5.2 percent of the petitioners had a debt-to-income ratio of less than 25 percent. In contrast, 61.7 percent of the debtor sample had consumer debt which was less than or equal to 25 percent of their annual before-tax income. Almost 45 percent of the petitioner sample had consumer debts that exceeded 100 percent of annual income compared to only 13.6 percent of debtors.[4]

Using the debt-to-income ratio as a measure of credit risk, one can conclude that relative to debt users in general, the petitioners were generally poor credit risks at the time they filed for debtor relief. One explanation for the frequency of very high debt-to-income ratios, besides the possibility of loss of job, is that petitioners added large amounts of debt to holdings immediately before filing for bankruptcy. However, only 11 percent of the petitioner sample reported that credit was used for purchases of more than $200 in the six months before they filed for bankruptcy.

## B. Types and Sources of Nonmortgage Credit

In the previous section we found that, on average, the petitioners owed about $19,000 in nonmortgage instalment debt at the time they filed for bankruptcy. In this section, we analyze the mix of secured versus unsecured credit in the consumer debt portfolios of the petitioners, the sources of unsecured credit and the collateral characteristics of the secured credit. Data used in this analysis were extracted from the bankruptcy petitions.

### 1. Unsecured Consumer Credit

On average, unsecured debts made up 63 percent of the total nonmortgage, nonbusiness debts in the petitioners' liability portfolios (Exhibit 2-3). Unsecured debt made up 80-100 percent of total consumer

## EXHIBIT 2-3

## UNSECURED DEBT AS PERCENT OF TOTAL DEBT*

(*NONMORTGAGE, NONBUSINESS DEBT)

| Unsecured Debt as Percent of Total Consumer Debt | Percent |
|---|---|
| 0-20 percent | 7.0% |
| 21-40 percent | 12.0 |
| 41-60 percent | 14.3 |
| 61-80 percent | 19.3 |
| 81-100 percent | 42.6 |
| Missing values | 4.8 |
| | 100.0% |

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

debt outstanding for slightly more than 40 percent of the petitioners. Twenty percent of the petitions indicated that the petitioners had no secured debt at the time of the filing. Only seven percent of the petitioners primarily held secured debt (0-20 percent unsecured).

The source of credit and the outstanding balances for the unsecured debts reported on the petitions were analyzed. In Exhibit 2-4 we have summarized the percentage of respondents who had credit from each lender type, the average total amount of consumer credit owed to each type of lender, the average number of different loans from each type of lender, and the average dollar value of the obligations to each type of lender.

The petitioners were most likely to have unsecured credit from banks, retailers, medical sources, or others. The petitioners who had credit from banks had, on average, two bank relationships, one or both of which was likely to have been credit card accounts. The petitioners who had retail credit balances, on average, had accounts with about four different retailers. Sixty-one percent of the sample had credit from medical sources. Those who had outstanding balances owed about $400 of credit from each of 4.6 different medical sources. Finally, about 75 percent of the sample owed an average of $5,154 to other sources--nonmortgage lenders who did not fall into any of the other categories or whose name was such that it could not be identified as a member of one of the other lender categories by the person coding data from the petition.

Only 40 percent of the sample had unsecured loans from finance companies. The average total balance owed to finance companies was $2,694 with an average loan balance of $1,604. Twenty-three percent of the petitioners had one or more members of the household who belonged to a credit union. Seventeen percent of the petitioners had unsecured loans from a credit union with an average balance of about $1600.

The pertinent point to be drawn from Exhibit 2-4 is the frequency with which unsecured credit sources other than the financial institutons were used by consumer debtors filing for bankruptcy and the large dollar amounts of credit obtained from these sources. It is frequently the case that credit sources which are primarily sellers of goods and services do not report to credit bureaus especially when they have a small volume of credit sales. Consequently, the credit bureau report available to potential creditors may have revealed only the tip of the iceberg of credit being used by these consumers.

It is feasible that these consumers borrowed from nonconventional sources of credit (which are likely not to have sophisticated collection systems) to the extent possible in order to continue making payments on loans from banks, finance companies, credit unions, and major retailers. When their ability to draw on these sources was exhausted, bankruptcy court was the obvious solution. This scenario could explain the observation made by many conventional creditors that many of their accounts that went bankrupt had never shown a delinquency before the bankruptcy petition was filed.

In Exhibit 2-5, information provided in Exhibit 2-4 is shown with the sample categorized by total nonmortgage debt-to-family income ratios. The petitioners in the highest debt-to-income category were more likely to have a loan and had a greater number of loans from banks, finance companies and credit unions than those in the lowest debt-to-income category. In addition, the petitioners in the highest category had

EXHIBIT 2-4

SOURCES OF UNSECURED NONMORTGAGE INSTALMENT CREDIT

| | Percent of Sample With Debt from: | Total Average Outstanding Balance from: | Average Number of Loans From Institutions of This Type: | Average Outstanding Balance Per Obligation: |
|---|---|---|---|---|
| Bank | 58% | $4,186 | 2.1 | $1,993 |
| Credit union | 17* | 1,919 | 1.2 | 1,599 |
| Finance company | 40 | 2,694 | 1.7 | 1,604 |
| Retailer | 77 | 1,840 | 3.8 | 483 |
| Dealer | 24 | 4,914 | 4.6 | 1,073 |
| Medical | 61 | 1,829 | 4.6 | 400 |
| Friend | 13 | 5,367 | 2.0 | 2,738 |
| Other, including not identified | 75 | 5,154 | 4.1 | 1,260 |

*Represents 74 percent of petitioners who belonged to a credit union.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

EXHIBIT 2-5

TYPE AND NUMBER OF CREDITORS

(AVERAGE)

| | Total Consumer Debt/ Pretax Family Income | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | <50% | | 50-74% | | 75-100% | | >100% | |
| | % Had Debt* | Average # | % Had Debt | Average # | % Had Debt | Average # | % Had Debt | Average # |
| Banks | (51) | 1.78 | (50) | 2.09 | (63) | 1.92 | (64) | 2.22 |
| S & L | (2) | 1.25 | (2) | 1.0 | (3) | 1.0 | (5) | 1.30 |
| Credit unions | (11) | 1.21 | (20) | 1.17 | (25) | 1.15 | (17) | 1.33 |
| Finance companies | (36) | 1.90 | (38) | 1.57 | (45) | 1.69 | (42) | 1.66 |
| Retailers | (71) | 2.93 | (78) | 3.15 | (80) | 3.32 | (77) | 4.58 |
| Dealers | (15) | 2.22 | (19) | 1.93 | (24) | 3.23 | (29) | 5.44 |
| Medical | (59) | 3.73 | (62) | 4.35 | (58) | 5.82 | (64) | 4.79 |
| Friends | (4) | 1.44 | (8) | 1.44 | (13) | 1.47 | (19) | 2.19 |
| Other | (69) | 2.87 | (72) | 3.21 | (74) | 3.19 | (78) | 4.97 |
| N | 213 | | 211 | | 130 | | 540 | |
| Average income | $11,461 | | $12,317 | | $12,594 | | $9,008 | |

*Percent who had debt from this particular type of creditor.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

obtained credit with greater frequency from retailers, dealers, medical sources and "others" than the petitioners in the lowest debt-to-income category.

The relationship between the ratio of unsecured debt relative to total consumer credit in each petitioner's portfolio and before-tax family income is shown in Exhibit 2-6. The distributions of the ratio of unsecured debt to total consumer debt were significantly different at the ten percent level across income groups. Fifty-one percent of petitioners in the lowest income category had unsecured credit that represented 80-100 percent of their total consumer credit outstanding compared to only 35 percent of those in the highest income category.

One could conclude that the consumer credit marketplace with its current information technology is unable to keep consumers from getting into financial distress. As consumers take on more debt relative to income they use more unsecured credit and increasingly depend on sources of unsecured credit that are less likely to check credit reports and, after granting credit, are less likely to report it to a credit bureau. In addition, such sources of credit are not likely to report delinquencies to a credit bureau. Not knowing the full extent of consumer's unsecured indebtedness, credit grantors cannot discipline the consumer in his or her use of unsecured credit unless consumers fully report outstanding debts on credit application forms.

### 2. Secured Credit

For each of the secured credit obligations listed on the petition, excluding mortgages, the type and market value of the collateral was

## EXHIBIT 2-6

## USE OF UNSECURED DEBTS BY INCOME GROUPS

| Ratio of Unsecured Debt to Total Consumer Debt | Income Groups | | | |
|---|---|---|---|---|
| | Less Than $5,000 | $5,000-9,999 | $10,000-19,999 | More Than $20,000 |
| 0-20 percent | 4% | 8% | 8% | 8% |
| 21-40 percent | 12 | 11 | 14 | 14 |
| 41-60 percent | 12 | 15 | 17 | 17 |
| 61-80 percent | 21 | 16 | 21 | 25 |
| 81-100 percent | 51 | 50 | 41 | 35 |
| | 100% | 100% | 100% | 100% |

Total may not sum to 100 percent due to rounding.

$\chi^2 = 28.43$ Significant at ten percent level of confidence.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

coded along with the outstanding balance at the time the petition was filed. The types, loan-to-market values ratios and average amounts of secured consumer credit are shown in Exhibit 2-7.

Half of the sample had at least one credit obligation secured by an automobile. (There were several cases where multiple automobiles and auto credit obligations were listed on the petition.) The petitioners' average outstanding balance per loan for auto credit was almost $3,700. More than half of the petitioners with auto credit indicated that the loan-to-value ratio was in excess of 100 percent. This is not surprising given the normally rapid depreciation of automobiles.

Forty-one percent of the sample had an average of 1.8 loans secured by household goods with an average balance on each of $850. Sixty-one percent of the petitioners had credit secured by household furnishings which had a loan-to-market value ratio greater than 100 percent. Under the federal exemptions most of this credit would be treated as unsecured if it was not purchase money credit.[5]

Few of the petitioners had credit secured by jewelry, or investment property. However, those loans secured by investment property had, on average, a $15,000 balance with the security valued at about $22,000. A small percentage of the petitioners reported having secured credit with an average balance of $3,696 that could not be classified in any other category.

In summary, the petition data indicate that the consumers who chose bankruptcy had amassed a huge amount of credit, with a heavy emphasis on unsecured credit obtained from retailers, medical sources and other nonclassifiable sources. Secured credit held by the petitioner was most

## EXHIBIT 2-7

## NONMORTGAGE SECURED DEBT

| Security | Percent of Sample With Type of Debt | Average Dollar Amount Per Loan | Loan/Market Value | |
|---|---|---|---|---|
| Automobile | 50% | $ 3,719 | <100% | 45% |
| | | | >100% | 55% |
| Recreational vehicle | 5 | 4,769 | <100% | 48% |
| | | | >100% | 52% |
| Furniture/Appliances | 41 | 859 | <100% | 39% |
| | | | >100% | 61% |
| Jewelry/Furs | 2 | 607 | <100% | 64% |
| | | | >100% | 36% |
| Investment Property | 2 | 15,297 | <100% | 78% |
| | | | >100% | 22% |
| Other (nonclassified) | 11 | 6,342 | <100% | 64% |
| | | | >100% | 36% |
| Nonspecified | 6 | 3,696 | <100% | 69% |
| | | | >100% | 31% |

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

frequently secured by personal vehicles and household furniture. For more than half of these credit obligations, however, creditors had considerable risk exposure in that the outstanding balance was greater than the market value stated on the petition.

The implications that can be drawn from this analysis relate to the efficiency of the market for consumer credit and the ability of the market to monitor the consumer's use of credit. Given the absence of complete information available to the creditor to evaluate the credit risk of a loan applicant, the responsibility of determining the amount of consumer debt that is managable, given the level and stability of income and other obligations, falls on the consumer. In the next section, we find that an inability to make this determination or abide by it was seen as an important cause of bankruptcy by many of the petitioners.

## III. Petitioners' Perception of Causes of Bankruptcy

Studies of trends in bankruptcy using cross-sectional as well as time-series data have found evidence that the total number of personal bankruptcies filed each year nationally is associated with the rate of national unemployment, the ratio of annual consumer debt repayments to annual personal income (Yeager, 1978), and to the divorce rate (Heck, 1981). We sought further insight into the causes of personal bankruptcy by asking the petitioners to indicate which factors or events caused their financial distress and ultimate bankruptcy. Those events most frequently cited were medical bills, buying too much on credit and increases in the cost of living (Exhibit 2-8). Marital problems, loss

EXHIBIT 2-8

IMPORTANT FACTORS LEADING TO BANKRUPTCY

| | Number | Percent |
|---|---|---|
| **Personal Problems** | | |
| Medical bills (doctors, hospitals) | 508 | 43%* |
| Marital problems (divorce, separation, alimony, child support) | 333 | 28 |
| Natural disasters (such as floods, hurricanes) | 19 | 2 |
| Death in the family | 53 | 4 |
| Addiction or dependency (Drugs, alcohol, gambling) | 41 | 3 |
| **Employment Problems** | | |
| Cutback in the number of hours worked | 200 | 17 |
| Laid off or fired from work | 318 | 27 |
| Your business failed | 175 | 15 |
| Business that employed you failed | 58 | 5 |
| Unable to work due to illness/accident | 246 | 21 |
| Lost second income | 189 | 16 |
| **Credit/Financial Problems** | | |
| Bought too much on credit | 526 | 44* |
| Credit was too easy to get | 334 | 28 |
| Unable to get creditors to extend loans/ agree to different payment schedule | 247 | 21 |
| Creditors tried to collect their money | 345 | 29* |
| Sued by creditors | 279 | 23 |
| Wages actually garnished | 152 | 13 |
| Some property repossessed | 118 | 10 |
| Cosigned on a loan that wasn't paid | 71 | 6 |
| Cost of living went up | 542 | 45* |
| Other(s) | 187 | 16 |

*Four most frequently mentioned causes.

Respondents could indicate multiple factors.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

of job and various actions taken by creditors to collect credit accounts were each cited by about one-fourth of the petitioners as a contributing cause of bankruptcy. When asked which one or two of the factors cited were the most important causes of bankruptcy (Exhibit 2-9) medical bills, using too much credit, marital problems and loss of job were most frequently indicated.

One would expect that the debt burden carried by a household would affect its susceptibility to unexpected changes in income attributable to loss of job, a breakup of a marriage, or a medical problem. It follows that the number of petitioners indicating a particular cause of bankruptcy may be different across petitioners grouped by their nonmortgage debt-to-family income ratios. The factors leading to bankruptcy cited by consumers in each of these debt-to-income (D/I) groups are shown in Exhibit 2-10. It is interesting to note that the three reasons cited most frequently by the first three groups (D/I <50%, 50-75%, 75-100%) were the same: medical bills, martial problems and excess use of credit. The group with instalment debt exceeding pretax income cited loss of job and own business failure more frequently than marital problems and excess use of credit. These data again provide some very interesting insight into the various paths of bankruptcy. Many of those in the highest debt-to-income category apparently arrived there by one of two routes: either they were overextended and lost a job or business, or they lost a job or had a business failure and subsequently became overextended in their use of credit (probably by drawing down lines of credit that had been approved before they lost their jobs). Those in the lower debt-to-

EXHIBIT 2-9

## MOST IMPORTANT FACTORS LEADING TO BANKRUPTCY

| | Number | Percent |
|---|---|---|
| Personal Problems | | |
| Medical bills (doctors, hospitals) | 183 | 15 * |
| Marital problems | 148 | 12 * |
| Natural disasters | 6 | 1 |
| Death in the family | 15 | 1 |
| Addiction or dependency | 10 | 1 |
| Employment Problems | | |
| Cutback in the number of hours worked | 57 | 5 |
| Laid off or fired from work | 143 | 12 * |
| Your business failed | 85 | 7 |
| Business that employed you failed | 22 | 2 |
| Unable to work due to illness/accident | 81 | 7 |
| Lost second income | 51 | 4 |
| Credit/Financial Problems | | |
| Bought too much on credit | 166 | 14 * |
| Credit too easy to get | 50 | 4 |
| Unable to get creditors to extend/ agree to different payment schedule | 47 | 4 |
| Creditors tried to collect money | 44 | 4 |
| Sued by creditors | 57 | 5 |
| Wages actually garnished | 47 | 4 |
| Some property repossessed | 8 | 1 |
| Cosigned on a loan that wasn't paid | 15 | 1 |
| Cost of living went up | 95 | 8 |
| Other | 100 | 8 |

*Four most frequently mentioned causes.

Respondents could indicate up to two factors.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

## EXHIBIT 2-10

## REASONS FOR BANKRUPTCY

## (MOST IMPORTANT)

| | Debt/Income | | | |
|---|---|---|---|---|
| | <50% | 50-75% | 75-100% | >100% |
| Number of cases | 213 | 211 | 130 | 540 |
| Personal Problems | | | | |
| Medical bills (doctors,hospitals) | *16.9% | *15.6% | *19.2% | *15.0% |
| Marital problems | *12.2 | *12.3 | *17.7 | 11.5 |
| Natural disasters | 0 | .5 | 0 | .7 |
| Death in family | 1.4 | .5 | 0 | 1.9 |
| Addiction or dependency | .9 | 2.4 | 0 | .5 |
| Employment Problems | | | | |
| Cutback of employment | 7.5 | 4.7 | 3.8 | 4.4 |
| Laid off, fired | 11.3 | 9.0 | 13.8 | *13.9 |
| Business failure--own | 1.9 | 2.8 | 2.3 | 11.7 |
| Business failure--employer | .9 | 1.4 | 2.3 | 2.0 |
| Disability | 5.6 | 7.6 | 4.6 | 7.0 |
| Loss of second income | 2.3 | 3.8 | 5.4 | 5.2 |
| Credit/Financial Problems | | | | |
| Used excess credit | *11.7 | *17.5 | *16.2 | *12.4 |
| Credit obtained too easy | 1.9 | 8.5 | 4.6 | 3.7 |
| Creditors uncooperative | 2.8 | 7.1 | 3.1 | 2.4 |
| Creditors attempt collection | 5.2 | 3.3 | 4.6 | 3.3 |
| Creditors sued | 7.5 | 1.4 | 5.4 | 5.2 |
| Creditors garnished | 6.6 | 4.7 | 4.6 | 2.4 |
| Property repossessed | 1.9 | .5 | 0 | .6 |
| Cosigner | .9 | .9 | .8 | 1.1 |
| Cost of living went up | 9.4 | 8.1 | 6.2 | 8.5 |
| Other | 7.5 | 9.9 | 13.1 | 10.3 |

*Three most likely causes of bankruptcy

Respondent could indicate more than one reason

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

income categories had more manageable debt burdens but may not have perceived it as such. They apparently fell victim to an emotional or physical trauma and used the bankruptcy option as a way to reduce their stress.

### A. Medical Bills

Almost two-thirds of the sample had medical bills outstanding at the time they filed for bankruptcy. Fifteen percent of the petitioners indicated that medical bills were one of the most important factors leading to their bankruptcy. Those petitioners who cited medical bills as the most important factor owed almost seven different medical sources of credit an average of about $550 each for an average total of almost $4,000 in unpaid medical expenses. In contrast, the petitioners in general owed an average of $400 to each of 4.6 medical credit sources for an average total of $1,840 in medical debts. Only 15 percent of the heads of household of those citing medical expenses as the cause of bankruptcy were unemployed at the time they filed for bankruptcy (compared to an overall unemployment rate of 20 percent). Apparently, the medical bills did not generally result from a condition that left the head of household permanently disabled.

### B. Marital Problems

Twelve percent of the sample cited marital problems as one of the most important causes of bankruptcy. The life cycle data shown in Exhibit 1-1 suggest that the petitioners were generally young people (less than 45 years old) with small children. A divorce at this stage in the life cycle could place great financial burdens on the parties involved. As might be expected, of those respondents who cited marital difficulties as the most important cause of bankruptcy, one-third were divorced single parents. About 36 percent were separated, with children, at the time of filing. Twenty-eight percent were separated or divorced and had no dependents. The balance of the subgroup indicated that they were single at the time the petition was filed.

### C. Excess Use of Credit

Fourteen percent of the sample indicated that one of the most important causes of bankruptcy was their excess use of credit although 44 percent of the sample cited this as a factor leading to their bankruptcy. However, this group did not have more nonmortgage instalment debt relative to income than the population of petitioners, although they obviously had more debt relative to income on average than the population of debt-users in general (Exhibit 2-2). This subgroup had less unsecured credit relative to total consumer credit than the petitioners. Only 34 percent of the "excess-credit" group had unsecured credit relative to total consumer credit of 80-100 percent while this was true for 43 percent of the petitioners. The sources of unsecured credit for this subset of the petitioners did not differ from those used by the population of petitioners. However, the average amounts owed to each source was several hundreds of dollars less. Sixty-two percent of the "excess-credit" group owed an average of $3,000 in unsecured loans to banks compared to $4,186 for petitioners in general. (See Exhibit 2-3 for comparable figures for total sample). Forty-six percent had loans from finance companies totalling an average of $2,500 compared to 40 percent of petitioners in general who owed $2,694 on average to finance companies. Almost 85 percent of the subgroup had credit from retailers totalling an average of $2,000 per petitioner. This compared to $1,840 owed to retailers, on average, by 77 percent of petitioners in general. The group was slightly less likely to use credit from dealers, medical sources, friends, or others than the petitioners in general. This subgroup was more likely, relative to petitioners in general, to have obtained credit from retailers, finance companies and banks although the differences were not large. The types and amounts of secured credit in the portfolios of this group did not differ significantly from that for the entire sample of petitioners.

### D. Loss of Employment

Historically, the number of personal bankruptcy filings is highly correlated with the unemployment rate. However, only 12 percent of the sample indicated that loss of employment was one of the most important factors leading to their bankruptcy. Of this group 58 percent were unemployed at the time they filed their petition for debtor relief compared to an unemployment rate of about 20 percent for the sample in general.

### E. Filing to Avoid Certain Creditors

Filing for bankruptcy to avoid paying certain creditors was given as a motivation for filing by almost 40 percent of the sample. Respondents most frequently wanted to avoid paying finance companies and banks (Exhibit 2-11). By comparing the percent of the sample that had unsecured credit from finance companies and banks, one gets a better idea of the importance of the desire to avoid creditors as a cause of bankruptcy.[6] For example, 58 percent of the petitioners had at least one unsecured

## EXHIBIT 2-11

## CREDITORS THAT PETITIONER DID NOT WANT TO REPAY

## (PERCENT OF SAMPLE WHO INDICATED EACH TYPE)

| | |
|---|---|
| Bank | 10.2% |
| Savings and loan | 2.8 |
| Credit union | 2.1 |
| Finance company | 13.5 |
| Retailer/dealer/contractor | 7.3 |
| Friend/relative/coworker | .8 |
| Doctor | 4.7 |
| Other | 8.2 |

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

loan from a bank and ten percent of the sample wanted to avoid repaying a bank. Therefore, about 17 percent of petitioners with bank loans indicated that one of their motives for filing bankruptcy was to avoid repaying their bank loans. In contrast, almost one-third of the petitioners who had a loan from a finance company indicated that they wanted to avoid repaying that loan.

The petitioners were asked to indicate the actions taken by creditors before the bankruptcy petition was filed. The actions most frequently indicated were threatening letters and phone calls, threats of repossession and threats of garnishment. Those that were cited as most important in influencing the decision to file for bankruptcy were frequent telephone calls, threats of and actual garnishment, and threats of repossession. Six percent of the petitioners had had no creditor collection action taken against them. In contrast, three percent of the petitioners who indicated that they filed bankruptcy to avoid repaying particular creditors indicated that no collection action had been taken against them before they petitioned for bankruptcy.

## IV. Record of Previous Bankruptcy

Currently the law specifies that a person may file for bankruptcy only once within a six year period. In addition, a record of a bankruptcy may be kept on the individual's credit report for ten years. Thus, a person who has a past bankruptcy may not find the credit markets accessible. However, one might expect that consumers who had mismanaged their personal finances to the point that they had to file for bankruptcy once might have a tendency to repeat that behavior unless they were unable

EXHIBIT 2-12

RECORD OF PREVIOUS BANKRUPTCY

| | # | % |
|---|---|---|
| Respondent never filed before | 313 | 26 |
| Spouse never filed before | 13 | 1 |
| Neither respondent or spouse had filed before | 770 | 64 |
| Respondent filed individually before | 50 | 4 |
| Spouse filed individually before | 33 | 3 |
| Respondent filed jointly with current spouse | 26 | 2 |
| Respondent filed jointly with former spouse | 21 | 2 |
| Spouse filed jointly with former spouse | 1 | - |
| No response | 2 | - |
| Total | 1229 | |

Multiple responses possible

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

to obtain credit after bankruptcy or the cost of bankruptcy was so high that it forced a modification of their credit-use practices. About nine percent of the sample of petitions involved at least one party who had filed for personal bankruptcy before (Exhibit 2-12). We analyzed the credit used by this group to determine if habitual financial mismanagement existed and to see if their portfolio of nonmortgage credit was obtained from sources that differed from those used by petitioners in general.

The most important causes of bankruptcy indicated by those petitioners who had filed before (Exhibit 2-13) were very similar to those for the total sample of petitioners (Exhibit 2-9). Medical bills, overuse of credit, and marital problems were indicated as the most important reasons by at least 13 percent of those who had declared bankruptcy at least once before. This group was less likely than the petitioners in general to indicate loss of job as one of the most important causes of bankruptcy (7.6 percent versus 12 percent). The fact that almost 15 percent of this subgroup (about the same percentage as the sample of petitioners in general) indicated overuse of credit suggests that the actual costs of bankruptcy under the old law were not great enough to discourage their future excess use of credit.

The distribution of the ratio of total nonmortgage debt to before-tax income for the petitioners who had filed for bankruptcy before was very similar to that for the petitioners in general. Almost 50 percent of the group which reported a prior bankruptcy had debt-to-income ratios of more than 100 percent compared to 45 percent of the petitioners in general. In addition, the distribution of the ratio of unsecured debt

## EXHIBIT 2-13

## MOST IMPORTANT CAUSE OF BANKRUPTCY

## FOR THOSE WHO HAD FILED BANKRUPTCY BEFORE

N=105

| | |
|---|---|
| Personal Problems | |
| Medical bills | *16.2% |
| Marital problems | *13.3 |
| Natural disaster | 0 |
| Death in family | 1.0 |
| Addition or dependency | 1.0 |
| Employment Problems | |
| Cutback in hours worked | 6.7 |
| Laid off, fired | 7.6 |
| Respondent's business failed | 9.5 |
| Employer's business failed | 1.9 |
| Disabled due to illness/accident | 6.7 |
| Lost second income | 5.7 |
| Credit Problems | |
| Bought too much on credit | *15.2 |
| Credit too easy to get | 3.8 |
| Unable to get loan extensions | 1.9 |
| Creditors tried to collect money | 6.7 |
| Sued by creditors | 4.8 |
| Wages actually garnished | 1.0 |
| Property repossessed | 0 |
| Cosigned on loan that wasn't paid | 1.9 |
| Cost of living went up | 5.7 |
| Others | 8.6 |

*Three most frequently mentioned causes

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

to total nonmortgage debt was not significantly different from the distribution for the whole sample. Forty-one percent of the group reporting a prior bankruptcy had unsecured debt that made up 80-100 percent of total nonmortgage debt compared to 42.6 percent of the whole sample.

In Exhibit 2-14 the unsecured credit sources used by the petitioners who had filed for bankruptcy before are summarized. It is interesting to note that relative to the petitioners in general (Exhibit 2-3) the group that had filed for bankruptcy before were more likely to have credit from medical sources and friends. Members of the prior bankruptcy group were less likely to have credit from each of the other sources of credit than the sample in general. In addition, prior bankrupts who had credit from those sources had smaller loans, on average. These data suggest that, in general, after consumers file for bankruptcy, they may have difficulty getting credit from some sources. However, given the data, it is very difficult to conclude that a bankruptcy significantly limits one's future use of credit. Nor does it seem to change credit use practices. The data concerning the dates of the prior bankruptcies were not collected. However, if the previous bankruptcies had generally occurred more than seven years before, these data may not provide a valid indicator of the availability of credit immediately following a bankruptcy.

## EXHIBIT 2-14

## SOURCES OF UNSECURED NONMORTGAGE INSTALMENT CREDIT

## (FOR THOSE WHO HAD FILED FOR BANKRUPTCY BEFORE)

Number of cases 105 petitions

Credit Sources:

| | | |
|---|---|---|
| Bank: | % with debt | 50.4% |
| | Number of loans | 2.1 |
| | Average loan size | $1331 |
| Credit Union: | % with debt | 19% |
| | Number of loans | 1 . |
| | Average loan size | $1408 |
| Finance Company: | % with debt | 37% |
| | Number of loans | 1.6 |
| | Average loan size | $1261 |
| Retailers: | % with debt | 69.5% |
| | Number of loans | 4.7 |
| | Average loan size | $454 |
| Dealers: | % with debt | 21.9% |
| | Number of loans | 4.4 |
| | Average loan size | $999 |
| Medical: | % with debt | 76% |
| | Number of loan | 4.8 |
| | Average loan size | $461 |
| Friends: | % with debt | 20% |
| | Number of loans | 2.1 |
| | Average loan size | $2659 |
| Others: | % with debt | 75% |
| | Number of loans | 5.3 |
| | Average loan size | $1465 |

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

## V. Petitioners' Information About Bankruptcy Procedures

### A. Source of Information

The restrictions on the use of the bankruptcy option, the specifications of which assets will be liquidated and distributed among creditors, and the steps that must be completed before a person is declared bankrupt are not highly complex. However, the process and its costs and benefits may involve a great deal of uncertainty for most consumers. In addition, persons who went bankrupt in the past were usually ostracized. An interesting question, therefore, concerns the way in which a person who eventually files for bankruptcy finds out about the bankruptcy process. In addition, there has been considerable speculation concerning the importance of lawyer advertising of bankruptcy services as a source of information. To address these issues, the petitioners were asked to indicate where they got the idea to declare bankruptcy. Their responses are summarized in Exhibit 2-15.

The most frequently indicated sources of information were own general knowledge or friends, relatives, and coworkers. The indication is that people are talking about bankruptcy publicly. People are not inclined to talk openly and publicly about personal situations of which they are ashamed. The frequency with which public discussion was indicated as the source of the idea to declare bankruptcy could mean that there is not a great deal of shame involved with filing for bankruptcy today.

Twenty-one percent of respondents indicated that a lawyer or legal aid service was their source of information about bankruptcy and 16 percent indicated that they had seen or heard an advertisement that was

## EXHIBIT 2-15

## SOURCE OF IDEA TO DECLARE BANKRUPTCY

| Source | # | % |
|---|---|---|
| Read article or book | 97 | 8 |
| Advertisement - newspaper/magazine | 124 | 10 |
| Advertisement - radio/television | 67 | 6 |
| Lawyer or legal aid service | 252 | 21 |
| Friend/relative/coworker | 334 | 28 |
| Credit counseling service | 31 | 3 |
| Employer | 11 | 1 |
| Own idea/general knowledge | 364 | 30 |
| Other | 64 | 5 |
| No response | 1 | -- |

Multiple responses possible

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

## EXHIBIT 2-16

## PETITIONERS' USE OF LEGAL ASSISTANCE

| | |
|---|---|
| Hired a lawyer to file bankruptcy: | |
| No | 4% |
| Yes | 96% |
| How lawyer was selected: | |
| Family lawyer | 20% |
| Referred by another lawyer | 15 |
| Advertisement | 16 |
| Recommended by friend, relative, coworker | 27 |
| Phone book | 12 |
| Other | 8 |
| No response | 2 |
| | 100% |
| Legal fees paid: | |
| Less than $100 | 3.4% |
| $100 - 200 | 7.8 |
| $201 - 300 | 19.0 |
| $301 - 400 | 24.5 |
| $401 - 500 | 17.0 |
| $501 - 1,000 | 11.3 |
| Greater than $1,000 | 1.0 |
| Did not use lawyer | 4.0 |
| No response | 12.0 |
| | 100.0% |

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

their source of information about bankruptcy. Since an advertisement could have been one for legal services, lawyer advertising was probably a significant factor in the discovery process for many petitioners.

### B. Use of Legal Assistance in Bankruptcy

Ninety-six percent of the petitioners filed for bankruptcy with the assistance of an attorney (Exhibit 2-16). Generally, the lawyer employed had been recommended by a friend, relative, or coworker or another lawyer. It follows that friends, relatives and coworkers must also be recommending a specific lawyer when they talk to others about the process of bankruptcy. The average fee paid for legal service was about $400. Fees paid to lawyers per petition ranged from $45 to $2,500.

### C. Knowledge of Chapter 13 (Reorganization)

An alternative to filing straight bankruptcy (Chapter 7) is for the petitioner to seek court protection from creditors under Chapter 13. Under Chapter 13 the debtor's secured credit obligations are written down to the fair market value of the collateral when the market value is less than the outstanding balance. The court-appointed trustee approves a living expenses budget for the petitioner and the rest of the petitioner's after-tax income is allocated among the creditors, secured creditors usually being paid first. Thus, creditors will receive a proportion of the outstanding balance under a schedule set up and approved in the Chapter 13 proceedings. The expected amount received by creditors in a Chapter 13 case cannot be less than what they would have recovered if the petitioner had taken straight bankruptcy. If the petitioner does not pay the trustee according to the schedule, the trustee may garnish the petitioner's wages, or ask the judge to dismiss the Chapter 13 schedule, in which case the creditors may once again initiate collection action.

Both a Chapter 7 and a Chapter 13 may be recorded on the petitioners' credit report for ten years after the court action. There is no time limit with regard to the frequency with which a petitioner can file Chapter 13 although the maximum payout period is usually three years. The petitioner would probably expect ultimately to repay more of his total outstanding debt under Chapter 13 than Chapter 7. However, by choosing Chapter 7, some debts that would be dismissed under Chapter 13 are not dismissed. Thus, it is difficult to make a general statement about the benefits net of costs of the two debt relief plans.

A consumer who is seeking debtor relief may choose Chapter 7 or Chapter 13. The choice should be a function of the relative costs and benefits of the two plans. However, in some court districts the choice may be influenced by the bankruptcy judge. The debtor's lawyer may direct the consumer to either Chapter 7 or Chapter 13 on the basis of what is known about the judge's past decisions. For the second quarter of 1981, 77 percent of total personal bankruptcies (Chapter 7 and Chapter 13) granted in the 20 bankruptcy court districts included in the study were Chapter 7 bankruptcies. The minimum was 60 percent in the district in Northern Illinois and the maximum was 92 percent in the Western Pennsylvania district.

The petitioners' knowledge of Chapter 13 was examined in this study. Sixty percent of respondents knew that there was an alternative legal process to the one they had used (See Exhibit 2-17). Of that group, two-thirds knew that the process was called Chapter 13. Those respondents most frequently indicated that the reason they did not seek relief from their debts under Chapter 13 was that their income was not high enough or their debts were too high. Twenty-one percent of those who knew about Chapter 13 had been advised against using that alternative by their attorney. We were not able to determine whether this advice reflected the lawyer's knowledge of the judge in the district or if the lawyer was trying to help the petitioner minimize the cost of bankruptcy.

## D. Knowledge of Ability to File for Bankruptcy in the Future

After filing for bankruptcy, a consumer is legally restricted from filing again within six years. Almost three-fourths of the sample knew that they could file again and the bulk of those who knew were also aware that they could file again in the seventh year (Exhibit 2-18). Of those who knew they could file for bankruptcy again, 85 percent indicated that they would not or did not expect to have to use that option again. Thus, one could conclude that the majority of petitioners did not believe *a priori* that the gains from filing for bankruptcy were great enough to entice them into bankruptcy as frequently as was legally possible. Of those who said they would consider filing for bankruptcy again, 15 percent had already filed for personal bankruptcy at least twice (this time and at least one time previously).

## EXHIBIT 2-17

## KNOWLEDGE OF CHAPTER 13 PROCEDURES

---

Heard of alternative legal process:

| | |
|---|---|
| Yes | 60% |
| No | 40 |
| | 100% |

Of those who had heard of alternative response:

What was process called?

| | |
|---|---|
| Chapter 13 | 68% |
| Other | 8 |
| Don't know | 24 |
| | 100% |

Why was Chapter 13 not used?

| | |
|---|---|
| Attorney advised against it | 21% |
| Spouse/friends advised against it | 0 |
| Not enough income/debts too high | 47 |
| To avoid paying particular creditors | 2 |
| No particular reason | 6 |
| Other | 27 |

---

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

## EXHIBIT 2-18

## KNOWLEDGE OF ABILITY TO FILE FOR BANKRUPTCY AGAIN

| | | |
|---|---|---|
| Cannot file again | | 6% |
| Don't know/No response | | 21 |
| Can file again | | 73 |
| Within: | | |
| 6 years or less | 17% | |
| 7 years | 45 | |
| 8 years and over | 5 | |
| Don't know/No response | 6 | |
| | | 100% |

Among those who knew they could file again, would they?

| | |
|---|---|
| Yes | 15% |
| No | 45 |
| Don't expect anymore problems | 14 |
| Don't intend to let this happen again | 25 |
| No response | 1 |
| | 100% |

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

### E. Knowledge of the Effect of a Bankruptcy on the Credit Report

When a consumer's debts are discharged in bankruptcy courts, a record of that event is made in their credit report and can remain there for ten years. This record would contribute to the costs of bankruptcy if creditors interpret that information as an indicator of high credit risk and refuse to extend credit to persons who have a bankruptcy in their past.

The extent to which respondents were aware of the effect of bankruptcy on their credit report was measured by asking each respondent directly whether his or her bankruptcy would be recorded on their credit report. Ninety-two percent of respondents knew that the bankruptcy would be recorded (Exhibit 2-19). Forty-five percent thought that the bankruptcy would remain on their credit record for seven years. By law, the record can be kept for ten years. Only six percent of the petitioners knew the record could be kept for ten years. One-fifth of respondents did not know how long the record of the bankruptcy would appear on their credit report.

## VI. Alternatives to Bankruptcy

When a consumer gets into financial difficulty there are several alternative actions that can be taken to bring the financial condition of the household under control. Given the long-term effects of a bankruptcy, one would expect that a petition for bankruptcy would be made only after unsuccessful attempts at alternative remedial actions had been made. The alternatives considered in this study were credit counseling, debt consolidation loans, selling assets, or rearranging loan payment schedules.

### EXHIBIT 2-19

## KNOWLEDGE OF IMPACT OF BANKRUPTCY ON CREDIT REPORT

### (PERCENT OF RESPONDENTS)

Knowledge that bankruptcy was recorded on credit report:

| | |
|---|---|
| No | 8% |
| Yes | 92 |
| | 100% |

How long will the bankruptcy be recorded on the credit report:

| | |
|---|---|
| Six years or less | 13% |
| Seven years | 45 |
| Eight years or over | 12 |
| Do not know/no response | 21 |
| | 92% |

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

Most of the petitioners had heard of the four alternatives to bankruptcy that were examined. Petitioners were most likely to have heard of debt consolidation loans or rearranging payment schedules (Exhibit 2-20). The petitioners were least likely to have heard about credit counseling.

We analyzed the petitioners' use of alternatives to bankruptcy and the reasons given by those who did not try these various alternatives prior to bankruptcy. The petitioners were most likely to have tried rearranging their debt payment schedules and least likely to have tried credit counseling. Those who had heard of the various alternatives to bankruptcy but had not tried them and gave a reason for not trying were most likely to say they had no assets or income and too much debt and therefore did not try. Eight percent of the total sample did not try any of the above mentioned alternatives before filing for bankruptcy.

We can glean several very interesting conclusions from these data. The first is that a third of the total sample of petitioners had obtained a debt consolidation loan before actually going bankrupt. With the change in the bankruptcy law and the huge surge in losses for unsecured creditors that followed, many of the providers of debt consolidation loans have ceased to make unsecured debt consolidation loans.[7] Thus, the Bankruptcy Reform Act of 1978 reduced the availability of an alternative that may be successfully used to avoid bankruptcy by many consumers. If so, it may have contributed to the continued high level of personal bankruptcies after the Bankruptcy Act went into effect.

## EXHIBIT 2-20

## ALTERNATIVES TO BANKRUPTCY

| | Heard About: | Heard About and Tried: |
|---|---|---|
| Credit counseling | 59% | 20% |
| Debt consolidation loans | 82 | 34 |
| Selling assets | 75 | 21 |
| Arranging different payment schedules | 81 | 54 |

Why alternatives were not tried:

| | Credit Counseling | Debt Consolidation | Selling Assets | Rearranging Payments |
|---|---|---|---|---|
| Heard about but did not try: | 38% | 47% | 53% | 25% |
| Reasons for not trying alternatives: | | | | |
| No assets | -- | -- | 41 | -- |
| Wanted to preserve assets | -- | -- | 4 | -- |
| No income | 8 | 10 | -- | 6 |
| Non-cooperative creditors | -- | 1 | -- | 3 |
| Over extended on credit | 10 | 11 | 1 | 5 |
| Did not think of it | 2 | 1 | -- | 1 |
| No reason | 11 | 8 | 2 | 5 |
| No response | 7 | 16 | 4 | 5 |
| | 38% | 47% | 53% | 26% |

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

The second conclusion concerns credit counseling. Only one-fifth of the sample had heard of and tried credit counseling. Half of those who were aware of credit counseling but did not try it thought their debt was too high or income too low for credit counseling to help. The rest gave no reason for not trying credit counseling. These responses indicate that few of those who really need credit counseling are aware of it and have enough confidence in the idea to try it before going to bankruptcy court. Undoubtedly, more resources must be employed in credit counseling to make that an effective alternative to bankruptcy.

## VII. Summary

The path to bankruptcy as revealed by analysis of this sample of petitioners was paved by an inordinately heavy use of consumer credit relative to family income. Petitioners had credit from a multitude of sources but were frequent users of unsecured credit from medical sources, dealers, retailers, friends and others. Those who had consumer instalment debt which totaled more than 100 percent of family income were heavy users of those sources of credit.

The petitioners most frequently indicated that one of the factors which was the most important cause of bankruptcy was a medical problem, a marital problem, loss of job, or excess use of credit. Each of these factors were mentioned with about the same frequency. Forty percent of petitioners said that one of the reasons they filed bankruptcy was a desire to avoid paying a particular creditor--most frequently a finance company or a bank.

About nine percent of the petitioners had filed for bankruptcy before. The causes of bankruptcy for this subgroup were about the same as for the sample in general except that this group was less likely to cite loss of employment. Their sources of credit as reported on their second bankruptcy petition were approximately the same as those for the sample in general. The repeat petitioner was slightly more likely than the sample in general to use credit from medical sources and friends.

Petitioners were most likely to get information about bankruptcy from their family, friends and coworkers. Many got the idea to file for bankruptcy from an advertisement and 96 percent of the sample employed a lawyer at an average fee of $400. Most petitioners knew about Chapter 13 but did not use it either because they did not have enough income to pay back any debts or because their lawyer advised against it.

Most petitioners knew they could file for bankruptcy again but only 15 percent said they would consider such action. Most also knew the bankruptcy would appear on their credit record. Only six percent knew that the bankruptcy would remain on their credit report for ten years.

The petitioners had heard of alternatives to bankruptcy and only eight percent filed for bankruptcy without attempting credit counseling, debt consolidation loans, selling assets or negotiating different terms with creditors. Relatively few had heard about and tried credit counseling. Most knew about it but did not try credit counseling and expressed doubt that they had enough income to repay their debts.

## FOOTNOTES

[1] See Monograph 23, Credit Research Center, Purdue University; Chapter 4 for an estimate of the cost of bankruptcy borne either by producers or creditworthy consumers who do not default or who, as a result of high perceived credit risk, are denied credit.

[2] Credit bureau reports do not purport to represent the universe but only a sample of the debtor's relationships and payment habits.

[3] The ratio of monthly debt payments to monthly income is a more meaningful measure of consumer indebtedness. However, data on size of monthly payments on outstanding credit for each petitioner were not available.

[4] More than 60 percent of those who seek financial counseling at offices of the Consumer Credit Counseling Service around the nation are married and owe more than 50 percent of their annual salary. Peter Costa, "Feel Buried by a Mountain of Debt?", Indianapolis Star, March 7, 1982, p. 1, section 5.

[5] See Monograph 23, Credit Research Center, Purdue University; Chapter 4 for the statement of the provision in The Bankruptcy Reform Act of 1978 governing such collateralized loans.

[6] We assumed the petitioner filed to avoid paying an unsecured creditor. If a consumer simply decides that he or she does not want to repay a secured creditor, the collateral will be repossessed and a deficiency judgment may be entered. If the consumer takes bankruptcy to avoid paying a secured debt, the collateral will be repossessed and the deficiency becomes an unsecured claim. The consumer would simply default on the loan if the expected cost of the deficiency judgment in a simple default is less than the expected cost of bankruptcy. Given the costs of bankruptcy, it seems logical that the consumer would choose default over bankruptcy to avoid paying a secured loan.

[7] "Weak Loan Business Hits Beneficial Hard, and Some Say a Takeover Is Its Best Hope," The Wall Street Journal, February, 1982.

# CHAPTER 3

# THE COSTS OF BANKRUPTCY

## I. Overview

The costs of resolving one's immediate financial problems by taking bankruptcy (Chapter 7) are a function of the value of assets forfeited relative to the amount of debt that is discharged and the cost of the petitioner's subsequent reduced ability to obtain credit. The first cost with regard to the value of assets forfeited is determined by state or federal laws governing bankruptcy. Those laws specify how the assets owned by the petitioner will be distributed among the various creditors listed on the bankruptcy petition. Unlike a business bankruptcy, the law with regard to personal bankruptcy specifies that the petitioner is entitled to keep a set of exempt assets with which to make a "fresh start" after bankruptcy. Nonexempt assets are available to satisfy the claims of unsecured creditors.

The value of personal and household goods which is exempt from the claims of creditors in a state is determined by The Bankruptcy Reform Act of 1978 unless that specification was overridden by individual states after the effective date of the Act in 1979. In those states that have not overridden the federal specification of exemptions, the petitioner may choose that definition of exemptions (state or federal) that is the most beneficial given the type and value of assets owned by the petitioner. As a result of this characteristic of the current personal bankruptcy legislation, it is likely that the "cost" of personal bankruptcy measured by the change in net worth (total assets minus total liabilities) before and after bankruptcy would be positive for most consumers, especially for those who were making optimal use of their option to take bankruptcy. In other words, the net worth or wealth of a petitioner will be greater after bankruptcy than it was before bankruptcy.

To understand the optimal use of the bankruptcy option (assuming the petitioner's motive is to maximize personal wealth) one should view the act of petitioning for bankruptcy as exercising an option contract. That contract allows the petitioner to buy back his or her unsecured debt obligations and reduce secured debt obligations to the market value of the underlying collateral, at an exercise price equal to the market value of nonexempt available assets. Available assets are defined as total assets less assets that serve collateral for secured credit. Other things being equal, the lower the exercise price, the higher is the gain from bankruptcy. Thus, one would not expect petitioners to file for bankruptcy when total available assets were significantly less than the exempted assets allowed in view of the fact that once used, the bankruptcy option cannot be used again within six years. Additionally, the more total available assets exceed the allowed exemptions the greater is the price of the bankruptcy option. Thus, the optimal time to exercise the bankruptcy option is when the market value of available assets is approximately equal to the allowed asset exemptions and the consumer has amassed as much unsecured credit as possible.

In this chapter, we tabulate the petitioners' expectations of asset losses from bankruptcy and calculate a measure of the effect of bankruptcy on the net worth of the petitioners. The distribution of the percentage change in net worth is analyzed relative to the economic characteristics of the petitioners, their exposure to asset losses, the composition of debt portfolios, the level of state exemption laws in the states where the data were collected, and their ability to repay debts out of income. Finally, we examined the petitioners' evaluations of their ability to obtain credit after bankruptcy from various credit sources.

## II. Expected Loss of Assets

When an individual files for bankruptcy, purchase money secured debts may be partially satisfied by repossession of the collateral. In order to keep the collateral, the petitioner must reaffirm the debt. In the event of reaffirmation, the outstanding balance of the secured loan is adjusted to the market value of the collateral if the market value is less than the outstanding balance. Otherwise, the debt is reaffirmed for the amount of the outstanding balance. Unsecured debts, including deficiencies that arise when the market value of the collateral on a reaffirmed secured loan is less than the outstanding balance, are paid out of proceeds from the liquidation of the pool of nonexempt available assets owned by the petitioner. Sixty-three percent of petitioners in our sample indicated that they did not expect to lose any assets as a result of filing for bankruptcy.

An analysis of total assets claimed exempt by the petitioner relative to total assets (excluding assets which have secured claims against them) declared on the petition indicated that there was considerable variation in the asset retention rate in the sample of

## EXHIBIT 3-1

## EXEMPT ASSETS AS PERCENT OF TOTAL AVAILABLE ASSETS

## (NONBUSINESS BANKRUPTCIES)

| | Absolute Frequency | Relative Frequency | Adjusted Frequency |
|---|---|---|---|
| 0[1] | 364 | 32.0% | -- |
| Less than 25 percent | 48 | 4.2 | 6.2% |
| 25-50 percent | 201 | 17.6 | 25.9 |
| 51-75 percent | 241 | 21.2 | 31.1 |
| 76-99 percent | 120 | 10.5 | 15.5 |
| 100 percent or more[2] | 165 | 14.5 | 21.3 |
| | 1139 | 100.0% | 100.0% |

---

[1] Cases where values for total assets, exempted assets, or secured debts were not provided on the petition.

[2] Exempted assets were greater than total available assets when petitioners claimed the maximum exemption in assets regardless of the fact that their equity was less than the allowed exemption.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

petitioners (Exhibit 3-1). The asset retention rate is revealed by the ratio of total market value of exempted assets listed on the petition (Schedule B-4) relative to the total market value of assets that were not serving as security on a loan. The denominator of the ratio is the total asset figure from the petition minus the lesser of the outstanding balance or the market value of security for each secured claim listed in Schedule A-2 (secured claims). About 68 percent of those providing enough information to make the necessary calculations had more than 50 percent of available assets exempted from the claims of unsecured creditors. About 21 percent reported exempt assets which were equal to or greater than 100 percent of available assets. About 32 percent of the sample who provided the information were heavily exposed to loss of assets. This finding is consistent with the questionnaire data where about 40 percent of the petitioners indicated that they expected to lose some assets as a result of bankruptcy.

An analysis of assets owned by the petitioners and their assessments of what they would lose, what was exempted and what was going to be kept through reaffirmation provides some insight into the specifics of asset redistribution in bankruptcy (Exhibit 3-2). The assets most likely to be owned by the petitioners were a car, furniture, and clothing. In more than 90 percent of the cases, those who owned one or more of those goods expected them to be exempt in the bankruptcy procedure. Petitioners planned to keep some assets (primarily a house, truck, car, or land) by reaffirmation. Few indicated that they expected to lose specific assets listed in Exhibit 3-2.

## EXHIBIT 3-2

## EXPECTED COST OF BANKRUPTCY: EFFECT ON ASSET OWNERSHIP

| | Percent of Sample who Owned: | Of Those Who Owned: | | |
|---|---|---|---|---|
| | | Keep Through Exemption | Reaffirmation | Lost |
| Financial assets | 14.2% | 85% | -- | 15% |
| House | 24% | 94% | 67% | 6% |
| Car | 60% | 91% | 47% | 9% |
| Truck | 12% | 93% | 53% | 0 |
| Recreation vehicle | 4% | 88% | 40% | 1% |
| Furniture or appliances | 72% | 96% | 22% | 8% |
| Jewelry/furs | 27% | 99% | 10% | 0 |
| Clothing | 76% | 100% | 6% | 0 |
| Land/investment property | 4% | 83% | 45% | .5% |

NOTE: Percents do not add to 100 percent for each type of asset because petitioners could have multiple assets in each category or because equity in asset was exempted but asset served as collateral for a purchase money loan and the loan was also reaffirmed.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

The asset retention ratio of a petitioner is determined by the level of allowed exemptions in the state where the petition is filed. In Exhibit 3-3 the distribution of the ratio of exempted assets to available assets in the low and high exemption states is shown. The petitioners in the high exemption states were significantly more likely to have exemptions which protected 50 percent or more of their total available assets than petitioners in the low exemption states. Thus, the petitioners in the high exemption states enjoyed a lower average cost of bankruptcy than petitioners in the low exemption states.

In summary, the expected loss of assets does not appear to represent a prohibitive cost for most petitioners who had made the decision to file for bankruptcy. Most did not expect to lose assets which were obtained via a purchase money loan because they planned to reaffirm the secured debts. Additionally, more than half of available assets were covered by exemptions for about 68 percent of the petitioners. However, only about 21 percent of the sample claimed exemptions which protected the total of their available assets. The decision to take bankruptcy would be rational for those with nonexempt assets only if the expected amount of unsecured claims discharged in bankruptcy exceeded the expected amount of assets forfeited.

### III. Estimated Change in Wealth From Bankruptcy

The balance sheet information provided on the bankruptcy petition permits an estimate of the net worth or wealth position of each petitioner, both before and after bankruptcy. The difference between the two is the increment in the petitioner's wealth attributable to bankruptcy.

## EXHIBIT 3-3

## ASSET EXPOSURE BY EXEMPTION LEVELS

## (NONBUSINESS BANKRUPTCY)

| Ratio Of Exempt Assets To Available Assets | Low Exemption States | High Exemption States |
|---|---|---|
| Less than 25 percent | 8.8% | 3.9% |
| 26-50 percent | 28.1 | 24.0 |
| 51-75 percent | 28.9 | 33.0 |
| 76-100 percent | 26.2 | 24.8 |
| Greater than 100 percent | 8.0 | 14.3 |
| | 100.0% | 100.0% |

$\chi^2 = 17.33$ Significant at ten percent level of confidence.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

Net worth before bankruptcy is equal to the difference between the market value of total assets and the face value of total liabilities (secured plus unsecured debts plus claims with priority). After bankruptcy, the petitioner's assets are equal to the total of assets retained through exemption and reaffirmation of secured claims plus any residual assets remaining after the claims of unsecured creditors are satisfied. Total liabilities are equal to the value of secured claims which were reaffirmed plus claims of creditors with priority. The secured debts total was the sum of the outstanding balance or market value of the collateral for each of the secured debts listed in the Schedule A-2 section of the petition.[2]

For the calculation of the effect of bankruptcy on the petitioners' wealth it was assumed that all secured debts were reaffirmed, even though the petitioner might not have had any equity in the asset. This assumption had no effect on the size of the dollar change in net worth calculation. For example, assume a petitioner listed only one asset, an automobile with market value equal to $3,000. The only liability listed was the loan for the vehicle with outstanding balance equal to $5,000. If the car was repossessed and the deficiency judgment were discharged in bankruptcy court,the petitioner would realize a $2,000 increase in net worth by filing for bankruptcy: net worth before: -$2,000; net worth after: $0. If the loan were reaffirmed, the loan balance would be reduced to the market value of the car. Again, the petitioner would realize an increase in net worth of $2,000: net worth before: -$2,000; net worth after: $0.

All of the information needed to calculate the change in net worth realized from filing a nonbusiness personal bankruptcy was available for only 860 petitioners or about 72 percent of the sample. An analysis of the income distribution for those petitioners who provided complete data versus the rest of the sample showed that the hypothesis that the two groups were not drawn from the same population was rejected at the ten percent level of confidence.[3] Thus, the conclusions drawn from the analysis of the small sample will be generalized to the population of nonbusiness petitioners.

The distribution of dollar value changes in net worth attributable to bankruptcy is shown in Exhibit 3-4. Thirteen percent of the sample actually realized a zero gain from bankruptcy before transactions costs. Slightly more than 40 percent of the petitioners realized less than a $5,000 increase in net worth. About 11 percent realized a gain in net worth of more than $20,000. Relative to the average before-tax family income of $10,400 reported by the respondents the gain realized by the average petitioner in bankruptcy represented a significant "windfall."

Those petitioners who were filing for bankruptcy but were going to realize a zero change in net worth before transactions costs appear to have made an irrational decision. These petitioners had assets that exceeded their exemptions by a considerable amount. In addition, they had total unsecured debts that were less than their nonexempt asset total. The effect of bankruptcy on their wealth position was that they lost assets equal to the write-down in value of unsecured debts. Consequently, the after bankruptcy net worth for this group was equal to the before bankruptcy level of net worth, before transactions costs. However, transactions costs are positive and other costs such as loss of access to credit markets may be material. Their action therefore suggests that perhaps they filed because the did not anticipate actually losing nonexempt assets. If unsecured creditors do not exercise their rights or are not allowed to, all nonexempt assets may not be liquidated in bankruptcy.

In Exhibit 3-5 we show the distribution of the dollar value of change in net worth from bankruptcy in our sample relative to the before-bankruptcy net worth position of the petitioners. The interesting point shown by this table is that most of those petitioners who had a large amount of net worth before bankruptcy gained nothing from bankruptcy. Those who filed with a negative net worth--71.8 percent of the sample reported liabilities exceeding assets--were most likely to realize the largest gains from bankruptcy.

The distribution of the percentage change in net worth realized by the sample indicated that the bulk of petitioners (53.6 percent) had a percentage change in household wealth of 101-200 percent (Exhibit 3-6). About 16 percent of the petitioners realized a gain in net worth in excess of 200 percent. These statistics indicate that most petitioners for personal bankruptcy realized large increases in wealth. In the next section, we analyzed these gains from bankruptcy relative to the asset retention ratio, before-tax family income, mix of secured versus unsecured consumer credit in the petitioner's portfolio, and state exemption levels.

EXHIBIT 3-4

DOLLAR VALUE OF GAIN FROM BANKRUPTCY

(CHANGE IN NET WORTH)

N = 860

| | Number | Percent |
|---|---|---|
| Less than zero | 2 | .2 |
| Zero | 113 | 13.1 |
| $0 - 2,500 | 92 | 10.7 |
| $2,5001 - 5,000 | 159 | 18.5 |
| $5,001 - 7,500 | 145 | 16.9 |
| $7,501 - 10,000 | 110 | 12.8 |
| $10,001 - 15,000 | 121 | 14.1 |
| $15,001 - 20,000 | 26 | 3.0 |
| Greater than $20,000 | 92 | 10.7 |
| | 860 | 100.0 |

SOURCE: Credit Research Center, Purdue University, Consumer BAnkruptcy Study.

## EXHIBIT 3-5

## PERCENT DISTRIBUTION OF CHANGE IN NET WORTH FOR GIVEN LEVEL OF NET WORTH BEFORE BANKRUPTCY

| | Net Worth Before Bankruptcy | | | | |
|---|---|---|---|---|---|
| Absolute Change in New Worth | Less than $-5,000 | $-5,000 to 0 | $1 to 5,000 | $5,001 to 15,000 | Greater than $$15,000 |
| Zero | 0 % | .2% | 12.4% | 50.0% | 80.0% |
| $1 - 2,500 | .3 | 12.1 | 48.3 | 17.6 | 7.1 |
| $2,500-5,000 | .8 | 52.4 | 19.1 | 11.8 | 1.2 |
| $5,001-7,500 | 17.8 | 24.6 | 7.9 | 11.8 | 3.5 |
| $7,501-10,000 | 22.2 | 7.7 | 4.5 | 4.4 | 2.4 |
| $10,001-20,000 | 35.1 | 2.4 | 6.7 | 2.9 | 3.5 |
| >$20,000 | 23.8 | 0 | 1.1 | 1.5 | 2.4 |
| | 100.0% | 100.0% | 100.0% | 100.C% | 100.0% |

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

## A. Factors Related to Changes in Wealth

### 1. Asset Retention Ratio

One would expect to find that those petitioners who had fewer exposed assets (equity in assets which was not exempt from the claims of unsecured creditors) would realize the greatest relative wealth benefits of bankruptcy. This would be due to the fact that in the circumstance where most assets were exempt, the assets of the petitioner would remain largely intact while liabilities would be reduced or totally discharged. The relationship between the distributions of the ratio of exempt assets to total available assets and the percentage change in net worth is shown in Exhibit 3-7.

Those petitioners who had more than 100 percent of available assets protected by exemptions were most likely to have realized a gain in net worth of more than 100 percent. Those petitioners who had unprotected assets were more likely to earn a lower percentage change in net worth. However, some petitioners realized very large percentage gains in net worth, irregardless of exemption coverage of available assets. This result is attributed to the very high level of unsecured debts relative to nonexempt assets for some members of the sample.

### 2. State exemption levels

The distributions of the asset retention ratios were significantly different in the low and high exemption states. Given the significance of the relationship between the measure of asset exposure and wealth gains from bankruptcy, we expected to find the distribution of wealth gains to be significantly different in the two treatment areas. The distributions of these two variables are shown in Exhibit 3-8. The

## EXHIBIT 3-6

## PERCENTAGE CHANGE IN NET WORTH

N = 860

| | Number | Percent |
|---|---|---|
| Zero | 115 | 13.4 |
| Less than 25 percent | 34 | 4.0 |
| 25-50 percent | 25 | 2.9 |
| 51-75 percent | 21 | 2.4 |
| 76-100 percent | 71 | 8.3 |
| 101-200 percent | 461 | 53.6 |
| Greater than 200 percent | 133 | 15.5 |
| | 860 | 100.0% |

SOURCE; Credit Research Center, Purdue University, Consumer Bankruptcy Study.

## EXHIBIT 3-7

## GAIN FROM BANKRUPTCY

N = 775

|  | Exempted Assets Relative to Available Assets |  |  |
|---|---|---|---|
| Percentage Change In Net Worth | Less than 50% | 50-100% | Greater Than 100 Percent |
| Less than 100 percent | 26.2% | 25.9% | 3.3% |
| 101-200 percent | 61.8 | 53.9 | 80.7 |
| Greater than 200 percent | 12.0 | 20.3 | 15.9 |
|  | 100.0% | 100.0% | 100.0% |

$\chi^2$ = 54.37 Significant at the ten percent level of confidence.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

distributions of changes in net worth are significantly different in the high versus low exemption states. However, the petitioners in the high exemption states were not significantly more likely to realize gains in excess of 200 percent than petitioners in the low exemption states.[4] The petitioners in the high exemption states were significantly more likely to realize a gain in net worth of less than 25 percent than petitioners in the low exemption states.[5]

3. Before-tax family income

An analysis of the distribution of before-tax family income relative to the wealth gains from bankruptcy showed that the distributions of wealth gains across income categories were not significantly different at the ten percent level of confidence.(Exhibit 3-9). In contrast to the low income categories, more petitioners in the highest income category gained less than 100 percent in terms of wealth. This is attributable to the fact that high-income petitioners had more assets and were more likely to have available assets which were not adequately protected by exemptions. In addition, high income petitioners used less unsecured credit than low income consumers. Thus, their gains from bankruptcy from reduced liabilities were limited and were offset to a large extent by a loss of assets. In contrast, low-income petitioners with few assets were more adequately protected from asset losses by the exemptions. Thus, their assets stayed the same and liabilities were reduced to the value of secured liabilities. The same percent of high income petitioners earned gains in excess of 200 percent of net worth as the petitioners in the lowest income categories.

EXHIBIT 3-8

GAINS FROM BANKRUPTCY BY EXEMPTION LEVELS

| Percentage Change In Net Worth | Low Exemption State | High Exemption State |
|---|---|---|
| Less than 25 percent | 14.4 | 19.7 |
| 25-50 percent | 3.3 | 2.5 |
| 51-75 percent | 1.7 | 3.2 |
| 76-100 percent | 11.3 | 5.3 |
| 101-200 percent | 55.3 | 51.9 |
| Greater than 200 percent | 13.9 | 17.4 |
| | 100.0% | 100.0% |

$\chi^2 = 16.78$ Significant at the ten percent level of confidence.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

An analysis of the wealth gains from bankruptcy relative to the mix of the petitioners' debt portfolios between secured and unsecured consumer debt adds support to the scenario provided above. Those petitioners whose debt portfolios were primarily unsecured debt were significantly more likely to realize gains in wealth in excess of 100 percent than those petitioners who primarily had secured credit in their portfolios (Exhibit 3-10). Those petitioners with little unsecured debt were most likely to realize an increase in net worth less than 100 percent.

### 4. Ability to repay debts

Finally, a formal analysis of the gains from bankrutpcy relative to the ability of petitioners to repay their debts out of income (as defined in Monograph 23, Chapter 3) showed that those petitioners who were judged as being able to repay 25 percent or less of their debts out of available income in 36 months were more likely to experience gains in wealth of 100-200 percent than those petitioners who could have repaid more than 75 percent of debts out of income over 36 months (Exhibit 3-11). However, those petitioners who could have repaid 25 percent or less of their debts within 36 months were not significantly more likely to have realized a gain in net worth of 200 percent or more than those who could have repaid more than 25 percent of their nonmortgage debts. Twenty-four percent of those petitioners who could have repaid most of their debts in 36 months gained less than 25 percent of their net wealth position before bankruptcy by taking bankruptcy.

In summary, our data show that significant gains in wealth are earned by most consumers who file bankruptcy. The bulk of petitioners realized more than a 100 percent gain in net worth. Almost 16 percent realized

## EXHIBIT 3-9

## GAINS FROM BANKRUPTCY BY INCOME

N = 860

| Percentage Change In Net Worth | Before-Tax Family Income: Less Than $5,000 | $5,000-$10,000 | $10,001-$15,000 | $15,001-$20,000 | Greater Than $20,000 |
|---|---|---|---|---|---|
| Less than 100 percent | 26.9% | 29.4% | 28.1% | 37.3% | 38.3% |
| 101-200 percent | 57.5 | 56.1 | 55.3 | 45.3 | 46.1 |
| Greater than 200 percent | 15.6 | 14.5 | 16.6 | 17.4 | 15.6 |
|  | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% |

$\chi^2 = 9.66$ Insignificant at the ten percent level of confidence.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

## EXHIBIT 3-10

## GAINS FROM BANKRUPTCY BY DEBT PORTFOLIO CHARACTERISTICS

N = 833

| | Percent Of Consumer Debt That Was Unsecured | | | | |
|---|---|---|---|---|---|
| Percentage Change In Net Worth | 0-20% | 21-40% | 41-60% | 61-80% | 81-100% |
| Less than 100 percent | 46.0% | 41.3% | 39.5% | 35.8% | 21.2% |
| 101-200 percent | 40.0 | 41.9 | 49.6 | 44.7 | 62.8 |
| Greater than 200 percent | 14.0 | 16.3 | 10.9 | 19.5 | 16.0 |
| | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% |

$\chi^2 = 63.36$ Significant at the ten percent level of confidence.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

a gain in net worth of more than 200 percent. Gains in excess of 100 percent were most likely to accrue to those petitioners who had assets exemptions which were more than 100 percent of available assets. Petitioners in the lowest income categories were more likely than those in the highest income categories to realize gains in net worth in excess of 100 percent. This phenomenon was attributed to the greater use of unsecured credit and lower ownership of nonexempt assets by the low-income petitioners relative to high income petitioners. Those petitioners who had unsecured debts making up 80-100 percent of total nonmortgage debts were more likely to realize gains in excess of 100 percent of net worth than those petitioners who held a greater percentage of secured credit. Finally, petitioners who could not have repaid more than 25 percent of their debts out of income within 36 months were more likely to realize gains in net worth in excess of 100 percent than those who could have repaid more than 25 percent of their debts.

### IV. Ability to Obtain Credit After Bankrutpcy

Given the special exemption of assets granted persons filing bankruptcy, possibly one of the most significant expected costs of filing bankruptcy should be the loss of access to credit markets after bankruptcy. Each respondent was asked to indicate whether he or she thought that it would be more or less difficult to obtain credit from various sources in the future. The majority of respondents thought that it would be more difficult to obtain credit after bankruptcy from banks, thrift institutions, finance companies and retailers (Exhibit 3-12). Only about one-fifth of the sample expected credit to be more difficult

## EXHIBIT 3-11

## GAINS FROM BANKRUPTCY BY ABILITY TO REPAY DEBTS

| | Percent Of Debts Repayable In 36 Months | | |
|---|---|---|---|
| Percentage Change In Net Worth | Less Than 25% | 25-75% | Greater Than 75% |
| Less than 25 percent | 15.1 | 13.1 | 24.2 |
| 75 percent | 4.6 | 8.1 | 5.9 |
| 76-100 percent | 7.9 | 11.1 | 7.8 |
| 101-200 percent | 58.0 | 48.5 | 44.2 |
| Greater than 200 percent | 14.2 | 19.2 | 18.0 |
| | 100.0% | 100.0% | 100.0% |

$\chi^2 = 23.36$ Significant at the ten percent level of confidence.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

to obtain from friends, family, coworkers, doctors and hospitals. Most respondents generally believed that there would be no change in the difficulty of getting credit from those sources in the future. The petitioners' expectations appear to be consistent with the facts that were displayed earlier--as those sources of credit were used at about the same rate as other petitioners by petitioners who were filing for bankruptcy for the second time. In general, credit from sellers of goods and services, where the finance charge may be embedded in the cost of goods, was not expected to be more difficult to obtain, and the facts suggest that that is true. However, credit does appear to be more difficult to get from financial institutions after bankruptcy.

The respondents were generally aware that filing for bankruptcy might affect their ability to get credit in the future. Almost 20 percent of the petitioners had been told by their lawyer or legal aid service that that was the case. The majority of respondents indicated that they just knew that to be the case (Exhibit 3-13).

## V. Summary

One would expect the incidence of bankruptcy to be a function of the expected cost of bankruptcy. The costs considered in this chapter were expected losses of specific assets, changes in net worth resulting from bankruptcy, and expected difficulty in getting credit in the future.

About 60 percent of the petitioners did not expect to lose any assets in bankruptcy, either because the assets were exempt or because the petitioners planned to reaffirm the debt. An analysis of the exemptions claimed by each petitioner relative to exposed assets as

## EXHIBIT 3-12

## DIFFICULTY IN GETTING CREDIT IN THE FUTURE

| | More Difficult | Less Difficult | No Change/ Same as Now | Don't Know | Total |
|---|---|---|---|---|---|
| Bank | 62% | 12% | 12% | 14% | 100% |
| Savings & loan | 53 | 9 | 11 | 17 | 100% |
| Credit union | 45 | 11 | 17 | 27 | 100% |
| Finance company | 62 | 10 | 11 | 17 | 100% |
| Retailer/dealer/contractor | 55 | 11 | 15 | 19 | 100% |
| Friends/family/coworkers | 15 | 13 | 60 | 12 | 100% |
| Doctor or hospital | 23 | 11 | 48 | 18 | 100% |

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

reported on the petition revealed that the petitioners' expectations of asset losses were consistent with the petition data. About two-thirds of the sample claimed exemptions that were at least 50 percent of their available assets. Slightly more than 21 percent listed exemptions that were at least equal to 100 percent of available assets. The rest of the sample was likely to lose some assets because exemptions were not sufficient to protect all available assets.

An analysis of the changes in wealth of the petitioners that was attributable to the act of taking bankruptcy shows that the gains from bankruptcy were, in general, more than 100 percent of net worth before bankruptcy. The distributions of changes in net worth was analyzed relative to coverage of assets by exemptions, income, debt portfolio characteristics, and exemption levels. The results indicate that the relative gains in wealth from bankruptcy were a significant function of the extent to which available assets were protected by exemptions. In addition, the percentage gains from bankruptcy were positively associated with the percent of unsecured credit in the consumer debt portfolio. Those who had the least ability to repay debts out of income were significantly more likely to experience very large gains in net worth than those who could have repaid some or most of their debts out of income. In the calculation of change in net worth, we assumed that nonexempt assets would be liquidated and the proceeds would be distributed to unsecured creditors. To the extent that creditors do not follow through on the liquidation procedures as specified by the law, the change in net worth actually realized by petitioners by filing for bankruptcy is understated,especially for high income consumers who have assets

## EXHIBIT 3-13

## SOURCE OF INFORMATION ABOUT FUTURE CREDIT AVAILABILITY

| | |
|---|---|
| Article/book | 3% |
| Newspaper/magazine | 2 |
| Radio/television | 1 |
| Lawyer/legal aid service | 17 |
| Friend/relative/coworker | 11 |
| Credit counseling service | 1 |
| Own idea/ just knew | 42 |
| Other | 22 |
| No response | 7 |
| | 100% |

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

unprotected by exemptions. In fact, we found that 490 petitioners declared exemptions that were less than three fourths of their available assets. If the creditors or the courts generally do not require that those nonexempt assets be liquidated in bankrutpcy, it is understandable that a considerable number of petitioners in our sample filed bankruptcy when our calculations showed no apparent wealth benefit of bankruptcy realized by those petitions.

The petitioners believed that there would be a detrimental effect of bankruptcy on their ability to get credit in the future. In addition, they perceived that their ability to get credit from lenders like banks and finance companies and retailers would be affected more than their ability to get credit from lenders like medical sources, and friends.

## FOOTNOTES

[1] Claims with priority are claims that do not get absolved in bankruptcy such as taxes payable.

[2] This calculation of net worth ignores transactions costs of bankruptcy such as legal fees.

[3]

| Income | Omitted Group | Included Group |
|---|---|---|
| < \$5,000 | 70 | 167 |
| \$5,001 - 10,000 | 94 | 262 |
| \$10,001 - 15,000 | 79 | 217 |
| \$15,001 - 20,000 | 48 | 86 |
| > \$20,000 | 48 | 128 |
| | 339 | 860 |

$\chi^2 = 5.07$ Not significant at ten percent level of confidence

[4] $\chi^2 = 1.72$ Insignificant at ten percent level of confidence

[5] $\chi^2 = 3.97$ Significant at the ten percent level of confidence.

# CHAPTER 4

# EFFECT OF THE LEVEL OF ASSET EXEMPTIONS AND BANKRUPTCY JUDGES

## I. Overview

The 1978 Bankruptcy Reform Act provided a uniform definition of exempted assets across states where previously the definition of exempted assets was determined by each state. The federal exemption level was high compared to that in many states, but could be overridden by specific state legislation (this action has been taken by 32 states to date). Thus, there exists a large amount of cross-state variation in the dollar amount of personal and household goods that is exempt in personal bankruptcy proceedings. This study was designed such that the effect of the exemption level on the bankruptcy phenomenon could be analyzed. Half of the sample came from states with low exemptions and half came from states with high exemptions.

The five low exemption states were a subset of those states that had overridden the federal exemption definition with lower exemption levels. The five high exemption states were selected from those states which had either not overridden the federal exemptions or had state exemptions that were higher than the federal exemption level. The homestead exemption was used as the basic criterion for determining whether a state had low or high exemptions.[1]

The homestead and personal property exemption for the low exemption states were:

| State | Homestead | Personal Property | Jewelry |
|---|---|---|---|
| Georgia | $5,000 | $200 per item or $3500 aggregate | $400 |
| Illinois | $10,000 | $300, plus $700 if head of family with whom he lives | Not specified |
| Louisiana | No dollar amount specified | general clothing and furnishings, no dollar amount specified | Not specified |
| Ohio | $5,000 real or personal property used as a residence | $200 per item; $400 cash on hand or money due | $400 for one item; $200 for each additional item |
| Virginia | $5,000 comprised of personal and real property, to be selected by him; veterans with at least 40% disability are entitled to an extra $2,000 exemption; plus clothing and furniture, etc. | | Not specified except for wedding rings |

The high exemption states operated under the federal exemption definition or had a state definition that was even higher than the federal definition. Those states were California, New York, Pennsylvania, Texas, and Wisconsin. The federal homestead exemption may not exceed $7,500 (per debtor) in real property or personal property that the debtor uses as a residence and $200 in value in any particular item of household furnishings, goods, wearing apparel, books, animals, crops, or musical instruments. No more than $500 in jewelry held for personal, family, or household use is exempt.[2]

Another factor that plays an important role in the personal bankruptcy process are the procedures followed by the presiding judge.

Different judges have very different ideas about the assets which should be listed on the petition. For example, in one court district where interviews were conducted, the judge did not believe that engagement and wedding rings should even be listed as assets on a petition. Additionally, the judge may influence a consumer's choice between a Chapter 7 bankruptcy or a Chapter 13. An analysis of decisions made by the judges in whose courts the data for this study were collected revealed that some judges approved very few Chapter 13s and all Chapter 7s over the three-month period before the interviews were taken (April-June 1981). The bankruptcy statistics for the judges in one court district included in the study indicated about 60 percent of petitioners were granted Chapter 7 relief. In contrast, in another court district 92 percent of personal bankruptcy cases were Chapter 7 cases. On average, Chapter 7 bankruptcies represented about 77 percent of personal bankruptcies filed in the 20 court districts included in this study for the three month period before the study data were collected. Nationally, the average was 73 percent. In the following chapter we analyze the effect of exemption levels and judges on the bankruptcy phenomenon.

## II. Exemption Levels

### A. Debtors' Choices Between Federal and State Exemptions

The petitioner may elect to file for bankruptcy under the exemption definition that is most advantageous. In some states on a joint petition, one petitioner may elect the federal and one may elect the state exemption. The choices of the petitioners in the sample grouped by low versus high exemption states were:

| | Low Exemption States | High Exemption States |
|---|---|---|
| Federal Exemption 11 U.S. C522 | 21.7% | 57.7% |
| State Exemption | 47.8 | 18.4 |
| Both Federal and State Exemptions | 11.0 | 8.7 |
| No Response | 19.4 | 15.2 |
| | 100.0% | 100.0% |

In Chapter 3, we analyzed the decision to take bankruptcy as if it were like exercising a call option contract. By exercising the option to declare bankruptcy, the petitioner is buying his or her outstanding unsecured debt contracts for the dollar value of nonexempt assets owned. Thus, the higher the amount of assets exempted, the lower is the exercise price of the option. Holding other things constant, the higher the amount of assets exempted, the wealthier (in terms of assets) a petitioner can be and still pay a low price to exercise the option. We hypothesize that a greater percentage of petitioners in the high-exemption states would come from the highest income bracket (more than $20,000) than in the low exemption states. In addition, we hypothesize that the distribution of total assets for the petitioners in the low exemption states would differ from that for the petitioners in the high exemption states. These hypotheses were tested by an analysis of the distributions of before-tax family income and total assets in the two treatment areas. However, the fact that almost 22 percent of petitioners in the low exemption states filed under the federal exemption definition may have reduced our ability to identify an effect of the exemptions in this study.

## B. Family Income

The distribution of total before-tax family income for petitioners in the low and high exemption states is shown in Exhibit 4.1. The income distributions were significantly different in the two treatment areas. In addition, there was a significant difference in the percent of petitioners in the highest income brackets in the two treatment areas.[3] Almost 18 percent of petitioners from the high exemption areas had annual family pre-tax income of more than $20,000 compared to almost 12 percent of petitioners in the low exemption areas. This difference supports our hypothesis that the higher the exemption level the lower the cost of bankruptcy for households with high income (and the accompanying high assets). Thus, high income households are more likely to exercise their option to take bankruptcy in high-exemption states than in low-exemption states.

An analysis of the income distributions of petitioners filing in the low exemption states under the federal specification of exemptions versus the state exemption specification indicated no significant difference in the income distributions of the two groups. This would suggest that the differences in the income distributions of petitioners in the low and high exemption states may be attributable to cost of living differences in the states included in the study. Further analysis of the effect of allowed exemptions on the bankruptcy phenomenon is currently being conducted with adjustments for differences in cost of living across states.

## C. Total Assets

If the level of exemptions allowed in each state had no effect on the bankruptcy phenomenon one would expect to find that tht dollar value of assets listed by each petitioner would be independent of the allowed exemption level. However, if the petitioners and their lawyers are truthful and consistent in terms of the declaration of assets and asset valuation across treatment areas, then evidence of differences in the upper end of the distributions of assets of petitioners in the two areas support our hypothesis. The distributions of total assets listed in Schedule B (total assets claimed by the petitioner at the time of the bankruptcy filing) of each petition are shown in Exhibit 4-2. The distributions were significantly different at the ten percent level of confidence. A significantly larger percentage of the sample in the high exemption states had more than $50,000 in total assets than the sample from the low exemption states.[4]

One of the most significant assets in the portfolios of individuals is the home. In addition, homeownership is somewhat limited to families in the higher socio-economic categories. The data in Exhibit 4-2 show that 28 percent of the sample of petitioners in the high exemption states owned their own home relative to 25.3 percent in the low exemption states. However, this difference was not significant at the ten percent level of confidence.

## D. Other Effects

An interesting phenomenon observed in the data base was the relationship between exemption levels and lawyer fees and the use of a lawyer. In the low exemption states the average fee paid to the lawyer

### EXHIBIT 4-1

### ANNUAL BEFORE-TAX FAMILY INCOME

| | Low Exemption | High Exemption |
|---|---|---|
| Number of cases | 598 | 601 |
| Income | | |
| \$0 - 5,000 | 20.9% | 18.7% |
| \$5,001 - 10,000 | 32.3 | 27.1 |
| \$10,001 - 15,000 | 25.3 | 24.1 |
| \$15,001 - 20,000 | 10.0 | 12.3 |
| > \$20,000 | 11.5 | 17.8 |
| | 100.0% | 100.0% |

$\chi^2 = 13.02$ Significant at ten percent level of confidence.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

## EXHIBIT 4-2

## EXEMPTION LEVELS AND TOTAL ASSETS OF PETITIONER

| Total Assets | Low Exemption | High Exemption |
|---|---|---|
| Less than $5,000 | 59.7% | 46.9% |
| $5,001 - 20,000 | 19.2 | 27.0 |
| 20,001 - 50,000 | 14.2 | 14.3 |
| More than $50,000 | 6.9 | 11.8 |
|  | 100.0% | 100.0% |

$\chi^2 = 24.81$ Significant at ten percent level of confidence.

| Home Ownership | | |
|---|---|---|
| Own home | 25.3 | 28.0 |
| Rent | 62.4 | 63.6 |
| Neither/other | 12.3 | 8.3 |
|  | 100.0% | 100.0% |

$\chi^2 = 5.66$ Significant at ten percent level of confidence.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

for bankruptcy council was $342. In the high exemption states the average was $422, a difference of $80. This phenomenon could reflect the fact that in high exemption states the change in net worth resulting from bankruptcy was significantly higher than that in the low exemption states (see Chapter 3). Consequently, people paid more to a lawyer to gain that benefit in the high exemption states. However, demand for lawyers' bankruptcy services exhibited price elasticity as fewer petitioners used a lawyer in the high exemption states (92 percent) than in the low exemption states (98.5 percent).

## E. Ability to Repay

One would expect consumers to choose to take bankruptcy when they were technically solvent or when they were able to repay their debts, when the benefits of bankruptcy after transactions costs were positive. In Chapter 3, we showed that the distributions of percentage gains in wealth were significantly different in the high exemption versus low exemption states. However, an analysis of the nonmortgage debt-to-pretax family income ratio (Exhibit 4-3) indicates that the distributions of the ratio in the two treatment areas were not significantly different. In both areas, almost 50 percent of petitioners had consumer debt that was greater than 100 percent of before-tax family income. The higher exemption level makes it possible for consumers with a fairly large amount of assets and income to declare bankruptcy at a lower cost in terms of assets lost. However, those same consumers had evidently amassed large quantities of debts, perhaps to acquire those assets. Thus, the ability of petitioners in the high exemption states to repay their debts out of income was insignificantly different from that for petitioners in the low exemption areas.

## EXHIBIT 4-3

## ABILITY TO REPAY EXEMPTION LEVEL

| Ratio Of Nonmortgage Debt-To-Income | Low Exemption | High Exemption |
|---|---|---|
| Not ascertained | 7% | 6% |
| 0-25 percent | 15 | 12 |
| 25-50 percent | 19 | 14 |
| 51-75 percent | 11 | 13 |
| More than 100 percent | 48 | 50 |
| | 100% | 100% |

$\chi^2 = 5.08$ Insignificant at the ten percent level of confidence

| | Portion of Nonmortgage Debts Repayable in 36 Months: | | |
|---|---|---|---|
| | Less Than 25% | 25-75% | Greater Than 75% |
| Low exemption | 66.1 | 10.5 | 23.4 |
| High exemption | 64.6 | 12.3 | 23.1 |

$\chi^2 = .94$ Insignificant at the ten percent level of confidence.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

## III. Effect of the Presiding Judge

The judge who presides in the bankruptcy court may influence a petitioner's choice between Chapter 7 or Chapter 13. It was learned in the process of data collection for this study that the judges' preferences with regard to Chapter 7 vs. Chapter 13 and with regard to the proper declaration of assets are quickly assimilated by lawyers appearing in court. This information in turn is conveyed to the petitioners seeking debtor relief. Recall that 21 percent of the petitioners in our sample who knew about Chapter 13 had been advised against taking it by their lawyers.

Of particular interest in this study is the way that the court handles Chapter 7 vs. Chapter 13 cases. It is clear from Exhibit 4-4 that some judges in our study areas hardly ever approved a Chapter 13 case (Western Pennsylvania). In other court districts, the judges maintained more balance between Chapter 7 and Chapter 13 cases. However, in none of our study districts did the judges collectively approve as many Chapter 13s as Chapter 7s.[5]

The proposed change in the bankruptcy law would mandate an entrance requirement to Chapter 7 such that the extent to which affordable debts were being excused in bankruptcy court would be reduced. We hypothesized that those judges who had a relatively low percentage of Chapter 7 cases in their courts were already imposing an informal "needs" test. If the judge limited the petitioner's ability to take a straight bankruptcy unless he or she truly could not repay debts in the specified period, he was already operating his court as it would be mandated under the proposed change in the law. As a result, we hypothesize that a smaller percentage

## EXHIBIT 4-4

## CHAPTER 7 AS PERCENT OF TOTAL PERSONAL BANKRUPTCIES

## (APRIL - JUNE 1981)

| Court District | Chapter 7 | Chapter 13 | Chapter 7 As Percent of Total |
|---|---|---|---|
| 1 Northern Georgia | 1004 | 629 | 61% |
| 2 Middle Georgia | 485 | 201 | 71 |
| 3 Northern Illinois* | 2561 | 1737 | 60 |
| 4 Central Illinois | 1047 | 129 | 89 |
| 5 Eastern Louisiana | 505 | 85 | 86 |
| 6 Western Louisiana | 408 | 121 | 77 |
| 7 Northern Ohio | 2753 | 904 | 75 |
| 8 Southern Ohio | 2169 | 880 | 71 |
| 9 Eastern Virginia* | 1456 | 192 | 88 |
| 10 Western Virginia | 604 | 190 | 76 |
| 11 Central California* | 4897 | 827 | 86 |
| 12 Northern California | 2316 | 904 | 72 |
| 13 Northern New York | 1179 | 124 | 90 |
| 14 Western New York | 1209 | 321 | 79 |
| 15 Central Pennsylvania | 802 | 518 | 61 |
| 16 Western Pennsylvania | 917 | 85 | 92 |
| 17 Northern Texas* | 487 | 183 | 73 |
| 18 Western Texas | 345 | 224 | 61 |
| 19 Eastern Wisconsin | 865 | 99 | 90 |
| 20 Western Wisconsin | 430 | 116 | 79 |

*U.S. Court District

SOURCE: Administrative Office of the U.S. Courts, Bankruptcy Division.

of Chapter 7 cases in those courts relative to the more liberal courts would have been excused of affordable debts. We selected those court districts from our study sample where Chapter 7 bankruptcies make up a relatively low percent of total bankruptcies and evaluated them as if they were test cases of the proposed change in the law.

The four court districts that had the lowest percent of Chapter 7 bankruptcies in our study courts were Northern Georgia (61 percent), Northern Illinois (60 percent), Central Pennsylvania (61 percent), and Western Texas (61 percent). We contrasted the petitioners from these courts (strict) to those from the four courts that had the highest number of Chapter 7's relative to total personal bankruptcies (lenient). They were Central Illinois (89 percent), Northern New York (90 percent), Western Pennsylvania (92 percent) and Eastern Wisconsin (90 percent).

The first comparison made was that of the ability of the petitioners to repay their nonmortgage, nonbusiness debts in three years out of current disposable income. The distributions of that variable for the petitioners in the strict court districts versus those in the lenient court districts are shown in Exhibit 4-5.

As we hypothesized, the petitioners for Chapter 7 who were processed in courts where the judges approved a smaller number of Chapter 7 cases relative to total personal bankruptcies (strict) were slightly less likely to be classified as able to repay 75 percent or more of their debts than those petitioners who were processed in the more lenient courts. However, the difference in the distributions was not significant. We next analyzed the income distributions of petitioners in the two

# EXHIBIT 4-5

# ABILITY TO REPAY BY COURT DISTRICT

N=489

| | Percent of Debt Repayable in 36 Months | | |
|---|---|---|---|
| Court District | Less Than 25 Percent | 25-75 Percent | More Than 75 Percent |
| Strict | 70.7% | 9.3% | 19.9% |
| Lenient | 69.1% | 9.5% | 21.4% |

$\chi^2 = .176$ Not significant at ten percent level of confidence.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

treatment groups. Those distributions are shown in Exhibit 4-6. Chapter 7 petitioners in the strict court districts were more likely to fall in the lowest income categories than petitioners in the lenient court districts. However, again, the distributions were not significantly different.

The differences here were not significant but the variance in the percentage of Chapter 7 to total personal bankruptcies for our study districts was not large (60 percent - 92 percent). An additional factor that weakens these tests is the fact that there were several judges presiding in each of our study districts. Within the districts there was considerable variation across judges in terms of the percentage of decisions that resulted in Chapter 7 bankruptcy versus Chapter 13. A stronger test of our hypothesis would involve tests at the level of judge rather than at the level of bankruptcy district. However, we were not able to associate petitioners with specific judges in our data base.

## IV. Summary

One of the more important provisions in the Bankruptcy Reform Act of 1978 was the one that imposed a federal definition of assets exempt from liquidation in bankruptcy. The federal definition allowed for the protection of a greater dollar value of personal assets relative to that allowed in some states. The federal definition could be overridden at the state level and was in 32 states. In this study, we selected half our sample from states with relatively low exemptions and half from states with high exemptions to test the effect of the exemption level on the bankruptcy phenomenon.

# EXHIBIT 4-6

## INCOME GROUPS BY COURT DISTRICTS

N = 489

| | Before-Tax Income | | | | |
|---|---|---|---|---|---|
| | Less Than $5,000 | $5,001-10,000 | $10,001-15,000 | $15,001-20,000 | Greater Than $20,000 |
| Strict | 21.5% | 32.5% | 25.2% | 8.5% | 12.2% |
| Lenient | 19.3 | 28.4 | 26.3 | 10.7 | 15.2 |

$\chi^2$ = 2.45 Not significant at the ten percent level of confidence.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

We hypothesized that the higher the value of assets exempted, the wealthier a petitioner could be and still suffer little loss in terms of assets. The distributions of income and assets in the two test areas were significantly different at the ten percent level. A significantly greater percentage of petitioners in the high exemption states fell in the highest income and asset categories than petitioners in the low exemption states. Further analysis of this phenomenon is required with adjustments for differences in the cost of living across states.

We also tested for the effect of the strictness of bankruptcy judges on the bankruptcy phenomenon. We hypothesized that in those districts where a Chapter 7 decision was more difficult to get, there would be relatively fewer consumers winning Chapter 7 judgments who could have repaid all or most of their debts. The tests did not support our hypothesis.

In conclusion, the exemption level defines the value of assets a petitioner can possess and still take bankruptcy at a low cost. The implication of this characteristics of personal bankruptcy legislation is that the number of households in a state who could be expected to file for bankruptcy is likely to be a function of the percent of households who have income and assets below some cut-off point that is related to the definition of asset exemptions which applies in that state.

## FOOTNOTES

[1] See Monograph No. 23, Credit Research Center, Purdue University; Chapter 2, for a more detailed discussion of the selection criterion used.

[2] The Compliance Handbook for Consumer Bankruptcy, prepared by the editors of Washington Credit Letter, 1980, p. 54.

[3] $X^2$ = 22.40 Significant at the ten percent level of confidence.

[4] $X^2$ = 8.86 Significant at the ten percent level of confidence.

[5] For the nation as a whole, Chapter 13s represented 27 percent of personal nonbusiness debt relief petitions filed in 1980.

# CHAPTER 5

# EFFECT OF THE PROPOSED CHANGE IN THE FEDERAL BANKRUPTCY LAW ON PETITIONERS FOR BANKRUPTCY

It has been proposed that the existing federal bankruptcy legislation be changed such that those petitioners who could afford to repay a reasonable portion of their debts from anticipated income would be denied access to Chapter 7. If they wish to get protection from their creditors while they were repaying a percentage of their debt they could file for Chapter 13. In other words, there would be a "needs" test that must be satisfied before a Chapter 7 bankruptcy would be approved. The petitioner's ability to repay his or her debts would be determined by the bankruptcy courts on the basis of income available after taxes and reasonable living expenses. In this study, we estimated the petitioners' ability to repay their debts out of current and future income given basic living expenses.[1] In this section, we will analyze the demographic profile of those who could have repaid some or all of their nonmortgage debts relative to those who could not have done so according to our definition. This analysis provides necessary insight into the characteristics of those who would be most affected by the proposed change in the law. In addition, we compare the causes of bankrutpcy, alternatives to bankruptcy and history of past bankruptcy for the petitioners grouped by ability to repay debts out of anticipated income.

## I. Ability to Repay

The ability of a petitioner to repay his or her debts out of income was calculated by finding the amount of monthly income after taxes and living expenses that would be available to repay existing nonmortgage, nonbusiness debts. Living expenses were the sum of actual current housing expenses supplied on the questionnaire including property taxes and insurance, utilities, the basic nonhousing living expenses per person for a family at the poverty level, and the excess current monthly medical, child care, and alimony expenses as indicated by the petitioner on the questionnaire. These expenses were subtracted from income after income and social security taxes to obtain the amount of monthly income available to repay debts. Given that amount, the percentage of debts that could be repaid over a 36-month period was calculated.[2] Those petitioners who could have repaid less than 25 percent of their debts within 36 months made up 65 percent of the sample. Those who could have repaid 25 to 75 percent made up 11 percent of petitioners and the other 23 percent could have repaid more than 75 percent of their nonmortgage debts within three years, assuming annual family income stayed at least at the level reported on the questionnaire. We assumed that those who could repay less than 25 percent of their debts in 36 months would be directed by the court to take Chapter 7 under the proposed change in bankruptcy legislation. We assumed that the other 35 percent of the sample would be denied admission to Chapter 13.[3]

## II. Demographic and Economic Characteristics

### A. Life Cycle

The life cycle characteristics of the petitioners grouped by ability to repay debts in 36 months (less than 25 percent, 25-75 percent, greater than 75 percent) are summarized in Exhibit 5-1. The most notable difference in the life cycle characteristics of the groups is that those who could have repaid 75 percent or more of their debts were more likely to be young and single with no children than those who could have repaid less than 25 percent of debts outstanding. This is further confirmed in Exhibit 5-2 where the distribution by marital status is shown. Those who could have repaid 75 percent or more of their debts were almost 30 percent more likely to have never been married than those who could have repaid less than 25 percent of their debts. Those who could have repaid some of their debts (25-75 percent, greater than 75 percent) had fewer dependents (2.9 compared to an average of 3.2) than those who could have repaid less than 25 percent of debts. Thus, these data suggest that those petitioners who would be required to attempt to repay some of their debts had fewer family obligations and were younger than those who would be approved to take Chapter 7. In general, the life cycle distributions for the three groups were not significantly different. However, comparisons of the two extreme groups did show differences in life cycle characteristics.

### B. Before-Tax Family Income

The distributions of current before-tax family income of the petitioners were analyzed relative to ability to repay. We found that the distributions of petitioners' income in each group were significantly

## EXHIBIT 5-1

## LIFE CYCLE

| | Portion Of Debts Repayable In 36 Months | | | | | |
|---|---|---|---|---|---|---|
| | Less Than 25% | | 25-75% | | Greater Than 75% | |
| Number of cases | 783 | | 137 | | 279 | |
| Less than 45 years old | | 68.6 | | 73.6 | | 70.3 |
| Single - no children | 14.3 | | 13.1 | | 17.6 | |
| Married<br>No children | 11.0 | | 13.1 | | 11.5 | |
| Children < 6 years | 28.5 | | 32.8 | | 29.0 | |
| Children > 6 years | 14.8 | | 14.6 | | 12.2 | |
| 45 years old or older | | 14.5 | | 16.1 | | 13.1 |
| Single - no children | 3.0 | | 2.9 | | 4.0 | |
| Married<br>No children | 4.5 | | 6.6 | | 5.5 | |
| Children | 7.0 | | 6.6 | | 3.6 | |
| Single with children | 15.2 | 15.2 | 9.5 | 9.5 | 16.1 | 16.1 |
| Missing values | 1.7 | 1.7 | .8 | .8 | .5 | .5 |
| | | 100.0% | | 100.0% | | 100.0% |

$\chi^2 = 23.03$ Not significant at ten percent level of confidence.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

## EXHIBIT 5-2

## MARITAL STATUS

| | Percent of Debts Repayable in 36 Months | | |
|---|---|---|---|
| | Less Than 25% | 25-75% | Greater Than 75% |
| Number of cases | 783 | 137 | 279 |
| Married | 56.6% | 65.0% | 54.5% |
| Separated | 9.2 | 8.0 | 6.8 |
| Divorced | 20.1 | 17.5 | 22.2 |
| Living as married | 1.5 | 1.5 | 1.1 |
| Single - never married | 10.6 | 7.3 | 13.6 |
| Widowed | 1.9 | .7 | 1.8 |
| No response | 0 | 0 | 0 |
| | 100.0% | 100.0% | 100.0% |

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

different. Generally, those who could have repaid more than 25 percent of their debts were more likely to have higher income than those who could have repaid less than 25 percent (Exhibit 5-3). A fourth of the petitioners who could have repaid 25 percent or more of their nonmortgage debts reported family income greater than $20,000. Almost 17 percent of those who could not have repaid their debts reported less than $5,000 in total before-tax family income while an average of 3.4 percent of those who could have repaid reported less than $5,000 in income. Only slightly more than eight percent of those who could not have repaid their debts fell in the highest income category.

A further indication of the degree of financial distress being experienced by the petitioners was their dependence on the federal food stamp program. Fourteen percent of the total sample received food stamps in the month before filing their bankruptcy petition. Eighteen percent of those petitioners who could not have repaid a significant amount of their debts over 36 months reported that they had received food stamps in the month before the survey was taken. Only about three percent of those who could have repaid some of their debts received food stamps. Those consumers seeking debtor relief who would have been required to repay some of their debts under the proposed law generally had significantly greater financial ability to do so than those who would have been allowed to take straight bankruptcy.

Those who could have repaid some of their debts were more likely to be currently employed and to have professional or managerial jobs than those who could not have repaid (Exhibit 5-4). They also had

## EXHIBIT 5-3

## TOTAL BEFORE-TAX FAMILY INCOME

| | Portion of Debts Repayable in 36 Months | | |
|---|---|---|---|
| Total Family Income (before tax) | Less Than 25% | 25-75% | Greater Than 75% |
| Number of cases | 783 | 137 | 279 |
| Less than $5,000 | 16.6% | 5.2% | 2.5% |
| $5,001 - 10,000 | 36.7 | 21.9 | 14.0 |
| $10,001 - 15,000 | 21.2 | 35.0 | 29.4 |
| $15,001 - 20,000 | 5.4 | 20.4 | 22.9 |
| Greater than $20,000 | 8.4 | 17.5 | 30.8 |
| Not ascertained | 11.7 | 0 | .4 |
| | 100.0% | 100.0% | 100.0% |

$\chi^2 = 277.51$ Significant at the ten percent level of confidence.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

## EXHIBIT 5-4

## OCCUPATION-HEAD OF HOUSEHOLD

| | Portion of Nonmortgage Debts Repayable in 36 Months | | |
|---|---|---|---|
| | Less Than 25% | 25-75% | Greater Than 75% |
| Number of cases | 783 | 137 | 279 |
| Professional or technical | 4.7 | 10.2 | 12.9 |
| Managerial, official or proprietor | 6.1 | 9.5 | 8.6 |
| Clerical | 7.5 | 10.2 | 7.9 |
| Sales | 4.9 | 5.1 | 5.7 |
| Craftsman, foreman | 17.9 | 23.4 | 24.0 |
| Operatives | 9.2 | 6.6 | 10.0 |
| Service workers | 12.0 | 12.4 | 6.5 |
| Laborers | 9.5 | 8.0 | 11.5 |
| Others | 1.9 | 3.6 | 2.5 |
| No response [1] | 26.3 | 10.9 | 10.4 |
| | 100.0% | 100.0% | 100.0% |

$X^2 = 72.81$ Significant at the ten percent level of confidence.

[1] Includes those who were not currently employed.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

significantly more education than those in the 25 percent-or-less category (Exhibit 5-5). Of those who could have repaid some or all their nonmortgage debts in 36 months, 38 percent had some college education or more compared to only 30 percent of the nonpaying group. Nonetheless, those who could have repaid some portion of their nonmortgage, nonbusiness debts were not significantly more optimistic about the expected growth in their income in the next year than those who could have repaid less than 25 percent of nonmortgage debts out of current income (Exhibit 5-6).

## III. Causes of Bankruptcy

The petitioners who could have repaid some of their debts (25-75 percent, greater than 75 percent) were more likely to have cited overuse of credit or easy credit as one of the most important cause of bankruptcy than those who could not have repaid their debts in 36 months (Exhibit 5-7). Those who could have repaid most of their debts were also less likely to attribute their financial problems to loss of job than the rest of the sample.

A different view of the most frequently mentioned "most important" causes of bankruptcy cited by the petitioners is provided in Exhibit 5-8. Two-thirds of the sample in general were deemed as lacking the financial resources to repay their nonmortgage debts. This group included three-fourths of those who cited medical bills as one of the most important cause of bankruptcy; 81 percent of those who cited loss of job; and 71 percent of those who cited marital problems. Thus, it appears that those who attributed their financial distress to medical bills, marital problems or loss of job were much more likely than petitioners in general to lack

## EXHIBIT 5-5

## EDUCATION-HEAD OF HOUSEHOLD

| Education | Portion of Nonmortgage Debts Repayable in 36 Months | | |
|---|---|---|---|
| | Less Than 25% | 25-75% | Greater Than 75% |
| Number of cases | 783 | 137 | 279 |
| Did not finish high school | 26.7% | 20.4% | 20.4% |
| High school graduate | 32.2 | 31.4 | 32.6 |
| Training or vocational school | 7.7 | 6.6 | 7.9 |
| Attended college courses | 22.1 | 26.3 | 25.9 |
| College graduate | 6.0 | 10.9 | 7.2 |
| Advanced college degree | 2.3 | 2.9 | 3.9 |
| No response | 3.0 | 3.6 | 2.9 |
| | 100.0% | 100.0% | 100.0% |

$X^2$ = 18.02 Not significant at the ten percent level of confidence.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

## EXHIBIT 5-6

## EXPECTED FUTURE INCOME

| Expected Change In Income In Next Year: | Portion of Debts Repayable in 36 Months<br>Less Than 25% | 25-75% | Greater Than 75% |
|---|---|---|---|
| Number of cases | 783 | 137 | 279 |
| Definitely higher | 24.5% | 24.1% | 27.1% |
| Probably higher | 28.2 | 26.3 | 26.4 |
| About the same | 6.5 | 3.8 | 6.6 |
| Probably lower | 3.8 | 3.0 | 5.5 |
| Definitely lower | 36.9 | 42.9 | 34.4 |
| | 100.0% | 100.0% | 100.0% |

$\chi^2 = 5.93$ Not significant at the ten percent level of confidence.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

## EXHIBIT 5-7

## MOST IMPORTANT CAUSES OF BANKRUPTCY

| | Portion of Debts Repayable in 36 Months | | |
|---|---|---|---|
| | Less Than 25% | 25-75% | Greater Than 75% |
| Number of cases | 783 | 137 | 279 |
| Personal | | | |
| Medical bills | 16%* | 14%* | 15%* |
| Marital problems | 12 | 13 * | 14 * |
| Natural disaster | 0 | 0 | 0 |
| Death in family | 1 | 0 | 1 |
| Addiction | 1 | 0 | 1 |
| Employment | | | |
| Cutback in hours | 6 | 2 | 4 |
| Laid off/fired | 14* | 7 | 8 |
| Own business failed | 8 | 10 | 4 |
| Employer's business failed | 2 | 2 | 2 |
| Unable to work | 8 | 6 | 4 |
| Lost second income | 4 | 3 | 5 |
| Credit Problems | | | |
| Used excess credit | 12* | 14* | 18* |
| Credit too easy to get | 2 | 7 | 8 |
| Creditors would not cooperate | 4 | 4 | 4 |
| Creditors attempted to collect | 4 | 3 | 4 |
| Sued by creditors | 5 | 4 | 4 |
| Wages garnished | 4 | 3 | 4 |
| Property repossessed | 1 | 0 | 1 |
| Cosigned on loan | 1 | 2 | 1 |
| Cost of living went up | 7 | 5 | 1 |
| Other reasons | 8 | 12 | 7 |

*Three most frequently mentioned causes

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

EXHIBIT 5-8

MOST IMPORTANT REASON

| | Portion of Debts Repayable in 36 Months | | |
|---|---|---|---|
| Most Important Cause | Less than 25% | 25-75% | Greater Than 75% |
| Medical bills | 75% | 9% | 16% |
| Marital problems | 71 | 7 | 22 |
| Laid off/fired | 81 | 6 | 14 |
| Too much credit | 63 | 14 | 22 |
| Total sample | 65% | 11% | 23% |

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

the financial means to repay their debts. The same statement could not be made for those who cited excess use of credit as the most important cause of bankruptcy.

Those who could have repaid some of their debts were significantly more likely to report that they filed for bankruptcy to avoid paying certain creditors than the rest of the sample (Exhibit 5-9). An analysis of the sources of unsecured credit used by the various groups (Exhibit 5-12) revealed that those who could have repaid more than three-fourths of their nonmortgage debts were more likely than the rest of the sample to have loans from a bank or finance company. We indicated earlier that in general those who filed bankruptcy to avoid paying certain creditors most frequently indicated that they wanted to avoid a finance company or a bank.

Although those who could have repaid more than three-fourths of their debts had a more negative attitude toward creditors, they were less likely to report that particular creditor actions had been taken against them than the rest of the sample (Exhibit 5-10). In fact, they were more likely than the rest of the sample to report that no creditor action had been taken against them before they petitioned for bankruptcy.

An analysis of the proportion of unsecured debt relative to total consumer debt in the portfolios of petitioners grouped by ability to repay showed that there were no significant differences in the use of unsecured credit across the groups. The bulk of the petitioners in each group had unsecured credit that comprised 80-100 percent of their total consumer credit portfolio (Exhibit 5-11).

EXHIBIT 5-9

## ABILITY TO REPAY DEBTS IN 36 MONTHS BY ATTITUDE TOWARD PAYING CREDITORS

| | Portion of Debts Repayable in 36 Months | | |
|---|---|---|---|
| Percent Who Filed To Avoid Certain Creditors | Less Than 25% | 25-75% | Greater Than 75% |
| Number of cases | 783 | 137 | 278 |
| Yes | 37.3% | 40.1% | 44.7% |
| No | 62.7 | 59.9 | 55.3 |
| | 100.0% | 100.0% | 100.0% |

$\chi^2 = 4.69$ Significant at the ten percent level of confidence.

Data reflect responses to the question: In talking with other people who have declared bankruptcy we have found some who told us that one of the reasons they declare bankruptcy was not so much to cancel all their debts as it was to avoid one or more specific creditors. Would you say that this situation applies to you?

SOURCE: Credit Research Center, Purdue Univeristy, Consumer Bankruptcy Study.

## EXHIBIT 5-10

## ACTIONS TAKEN BY CREDITORS TO COLLECT LOAN

| | Percent of Debt Repayable in 36 Months | | |
|---|---|---|---|
| | Less Than 25% | 25-75% | Greater Than 75% |
| Number of cases | 783 | 137 | 279 |
| Actions: | | | |
| Threaten repossession | 45% | 34% | 42% |
| Repossessed collateral | 21 | 13 | 18 |
| Sought deficiency judgment | 13 | 9 | 13 |
| Threatened foreclosure | 15 | 11 | 9 |
| Foreclosed on home | 4 | 2 | 3 |
| Threatened garnishment | 42 | 40 | 39 |
| Garnished wages | 20 | 17 | 16 |
| Telephoned frequently | 80 | 81 | 74 |
| Visits to home or work | 32 | 20 | 24 |
| Threatening letters | 70 | 74 | 71 |
| Contacted cosigner | 10 | 6 | 8 |
| Contacted employer | 29 | 26 | 25 |
| Contacted relative | 31 | 23 | 29 |
| No action taken | 5 | 4 | 8 |

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

## EXHIBIT 5-11

## DEBT PORTFOLIO CHARACTERISTICS

| Ratio of Unsecured Debt, Nonmortgage to Total Debt | Portion of Debts Repayable in 36 Months: Less Than 25% | 25-75% | Greater Than 75% |
|---|---|---|---|
| 0-20 percent | 7.9% | 5.8% | 5.0% |
| 21-40 percent | 12.4 | 13.1 | 10.4 |
| 41-60 percent | 12.4 | 19.0 | 17.6 |
| 61-80 percent | 18.1 | 19.7 | 22.2 |
| 81-100 percent | 44.1 | 39.4 | 40.5 |
| Missing | 5.1 | 2.9 | 4.3 |
| | 100.0% | 100.0% | 100.0% |
| Average: | 63.1% | 63.3% | 64.4% |

$\chi^2 = 13.87$ Not significant at the ten percent level of confidence.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

The analysis of the sources of unsecured credit used by the petitioners in each group (Exhibit 5-12) suggests that the source of credit used did not differ markedly across the groups except for the use of medical credit. Those who could have repaid more than three-fourths of their debts were less likely to have medical credit than those in the other two groups. However, the petitioners in the highest ability group were less likely to have filed for bankruptcy because of medical bills than those in the group with the least ability to repay debts. In addition, the average amount of loan from each source was usually several hundreds of dollars lower for those who could have repaid 75 percent or more of their debts than for those who could not have repaid their debts. This differential characterized the debt owed to banks, finance companies, dealers, friends, and others.

## IV. Alternatives to Bankruptcy

Those petitioners who could have repaid some of their debts were more likely than the rest of the sample to have heard of credit counseling, consolidation loans and rearranging payments (Exhibit 5-13). The percentage of each group who knew about and tried the various alternatives to bankruptcy was about the same across groups. The petitioners who could have repaid more than three-fourths of their debts were also more likely to have reported that they had heard about Chapter 13 than the rest of the sample.

## EXHIBIT 5-12

## SOURCES OF UNSECURED CREDIT

| | | Portion of Nonmortgage Debts Repayable in 36 Months | | |
|---|---|---|---|---|
| Source of Credit | | Less Than 25% | 25-75% | Greater Than 75% |
| Bank: | a. % with loan | 55% | 66% | 62% |
| | b. # of loans | 2.07 | 2.32 | 2.06 |
| | c. Average balance | $2197 | $2310 | $1296 |
| Credit Union: | a. % with loan | 16% | 19% | 18% |
| | b. # of loans | 1.23 | 1.42 | 1.16 |
| | c. Average balance | $1608 | $1488 | $1660 |
| Finance Company: | a. % with loan | 39% | 41% | 44% |
| | b. # of loans | 1.66 | 1.41 | 1.83 |
| | c. Average balance | $1865 | $1311 | $1138 |
| Retailers: | a. % with loan | 76% | 79% | 78% |
| | b. # of loans | 3.82 | 4.33 | 3.53 |
| | c. Average balance | $476 | $441 | $527 |
| Dealers: | a. % with loan | 25% | 28% | 19% |
| | b. # of loans | 4.94 | 4.67 | 3.23 |
| | c. Average balance | $1193 | $897 | $546 |
| Medical: | a. % with loan | 63% | 62% | 53% |
| | b. # of loans | 4.73 | 4.56 | 4.02 |
| | c. Average balance | $393 | $455 | $393 |
| Friends: | a. % with loan | 13% | 21% | 8% |
| | b. # of loans | 2.03 | 2.07 | 1.50 |
| | *c. Average balance | *$5168 | $3705 | $2194 |
| Others: | a. % with loans | 73% | 72% | 74% |
| | b. # of loans | 4.50 | 3.73 | 3.11 |
| | c. Average balance | $1672 | $2147 | $623 |

*Excluding one case for $1,501,000 owed on a libel suit.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

## EXHIBIT 5-13

## ALTERNATIVES TO BANKRUPTCY CONSIDERED AND TRIED

| | Portion of Debts Repayable in 36 Months | | |
|---|---|---|---|
| | Less than 25% | 25-75% | Greater Than 75% |
| Number of cases | 783 | 137 | 279 |
| Heard of: | | | |
| Credit counseling | 58% | 60% | 71% |
| Debt consolidation loans | 80 | 88 | 84 |
| Selling assets | 76 | 76 | 72 |
| Rearranging payments | 80 | 80 | 82 |
| Chapter 13 | 59% | 61% | 66% |
| Of those who heard, who tried: | | | |
| Credit counseling | 60% | 52% | 61% |
| Debt consolidation loans | 49 | 52 | 52 |
| Selling assets | 39 | 37 | 32 |
| Rearranging payments | 85% | 83% | 83% |

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

## V. Recurrent Bankruptcy

The petitioners who could have repaid almost all of their debts (greater than 75 percent) were more likely than the rest of the sample to report that they would consider filing for bankruptcy again the future (Exhibit 5-14). However, those who could not have repaid a significant portion of the debts had the highest incidence of at least one previous bankruptcy (11.6 percent).

## VI. Summary

An effect of the current bankruptcy law which specifies no restrictions on admission to Chapter 7 is that consumers who had the financial ability to repay some of their debts had their debts discharged. Given the definition of ability to repay used in this study, the petitioners were grouped by the percent of their debts that could have been repaid in 36 months out of current income (less than 25 percent, 25-75 percent, greater than 75 percent). Almost 35 percent of petitioners could have repaid some or all their nonmortgage, nonbusiness debts within a 36 month period (25-75 percent, greater than 75 percent). Analysis of those consumers who could have repaid some or all of their debts revealed that a large percentage were young, single consumers. The distribution of income for those who could have repaid a significant percentage of their debts showed that they were more likely to fall in the high income categories than those who could not have repaid their debts. In addition, their ability to earn in the future measured by education and occupation was considerably more attactive than that of the group that could have repaid less than 25 percent of debts. We conclude from this analysis of demographic characteristics of the petitioner groups that

## EXHIBIT 5-14

## ATTITUDE TOWARD FILING FOR BANKRUPTCY AGAIN

| | Portion of Debts Repayable in 36 Months | | |
|---|---|---|---|
| | Less Than 25% | 25-75% | Greater Than 75% |
| Legal to file for bankruptcy again? | | | |
| Yes | 91.2% | 97.0% | 94.6% |
| Would you consider bankruptcy again? | | | |
| Yes | 15.0% | 10.4% | 17.4% |
| No | 46.7 | 46.2 | 40.6 |
| Don't expect any more problems | 14.0 | 15.1 | 15.0 |
| Don't intend to let this happen again | 24.3 | 28.3 | 27.1 |
| | 100.0% | 100.0% | 100.0% |
| Previous Bankruptcy | | | |
| Have filed before | 11.6% | 10.4% | 8.8% |

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

the proposed change in the bankruptcy law will not place an intolerable burden on poor down-trodden consumers who have little prospect for improving their financial situations.

The debt portfolios of the three groups of petitioners had basically the same characteristics with regard to portion of unsecured credit and sources used. However, those petitioners who could repay most of their debts had smaller amounts of unsecured credit from most sources used.

A comparison of causes of bankruptcy across the three groups indicated that those who could have repaid the bulk of their debts were much more likely to have cited abuse of credit and much less likely to have suffered loss of employment than the group who could have repaid only a small percentage, if any, of their outstanding debts. Those petitioners who cited marital problems, medical bills, and loss of job were more likely than the population in general, to be classified as having little ability to repay their debts.

The petitioners who could have repaid 75 percent or more of their debts were the least likely of the three groups to have previously filed for bankruptcy, but were the most likely of the three groups to indicate that they would consider filing for bankruptcy again. Considering the increase in wealth that was realized by most of these petitioners, one should not be surprised that they would consider tapping that source of enrichment as often as the law would allow.

# FOOTNOTES

[1] See Monograph 23, Credit Research Center, Purdue University; Chapter 3 for a description of the specific details of the calculation of ability to repay debts.

[2] The percentage of debts that were repayable within 36, 48, and 60 months were calculated and discussed in Monograph 23.

[3] See Monograph 23, Chapter 4 for an analysis of the amount of debts recovered under these assumptions.

[4] Test of education differences in lowest and highest groups by ability to repay

|  | Less Than 25% | Greater Than 75% |
|---|---|---|
| Less than high school | 27.5% | 21.0% |
| High school-vocational school | 41.1 | 41.6 |
| Some college or more | 31.4 | 37.4 |
|  | 100.0% | 100.0% |

$\chi^2 = 5.30$ Significant at the ten percent level of confidence.

# CHAPTER 6

# CONCLUSIONS AND IMPLICATIONS

## I. Characteristics of Chapter 7 Petitioners

In this monograph, the causes, costs, and benefits of personal bankruptcy for a sample of consumers petitioning for bankruptcy in mid-1981 under Chapter 7 of the Bankruptcy Reform Act were analyzed. The results of the study show that the typical petitioner for bankruptcy was a head of household, between the ages of 25 and 34, with small children, holding a high school degree and employed in an unskilled or semiskilled position in the labor force. The typical petitioner had consumer debts that exceeded the amount of annual before-tax family income and could have reapid less than 25 percent of nonmortgage debts out of income after expenses within a 36-month period. In considerable contrast to that image of the typical petitioner for bankruptcy, we found a significant subgroup of petitioners in our sample who had nonmortgage debts that were less than 50 percent of annual before-tax income and who could have repaid 75 percent or more of those debts out of income within 36 months.

The most important self-perceived causes of bankruptcy were medical bills, marital problems, loss of job, or excess use of credit. Many petitioners indicated that they had filed to avoid repaying a particular creditor and were most likely to indicate that they did not want to repay a bank or a finance company.

About 63 percent of the debts in the portfolios of the petitioners was unsecured with many petitioners having unsecured credit that made up 100 percent of their consumer debts. The average petitioner had 12.27 different unsecured obligations. Twenty percent of the total dollar value of unsecured debt in the portfolios of the petitioners came from banks, 21 percent from retailers and dealers, nine percent from medical sources and nine percent from consumer finance companies.

The bulk of nonmortgage secured credit in the portfolios of the petitioners was secured by an automobile or household furniture and appliances. Only 27 percent of petitioners owned their own home. All homeowners had a mortgage on their principal residence that was equal, on average, to 66 percent of the declared market value of the residence. Only nineteen percent of the petitioners who owned a home had a second mortgage loan.

From the information contained in the study on the sources and amounts of credit used by petitioners, one is led to the conclusion that the consumer credit market, with its current fractionalized structure and information system, cannot keep a consumer from using an excess amount of consumer credit, given the level and stability of the individual's income. Consumers petitioning for bankruptcy used large amounts of unsecured credit from many different sources, especially sellers of goods and services. Much of this credit is unlikely to be reported on a credit report. Therefore, unless a consumer provides complete information about his or her total outstanding debts on a credit application, a creditor considering a credit applicant has an incomplete assessment of the applicant's financial position.

## II. The Costs of Bankruptcy

One of the primary forces that would motivate a consumer to limit credit use to a manageable amount given the uncertainty of future income and risk preferences would be the expected costs of bankruptcy. The results of our analysis suggest that most petitioners expected to lose very little in the way of assets by filing for bankruptcy. In addition, our calculations of petitioners' net worth before and after bankruptcy indicated that most of the petitioners enjoyed a very sizeable increase in wealth as a result of filing for bankruptcy. The petitioners generally expected credit to be more difficult to obtain after bankruptcy. However, they believed that many sources of credit, especially sellers of goods and services, would continue to be accessible to them. An analysis of the debt portfolios of petitioners in our sample who were filing for bankruptcy for a least the second time indicated that the types and amounts of consumer credit used after a bankruptcy were not significantly different from those used before bankruptcy. Thus, loss of access to credit markets may not be a significant cost of bankruptcy either in perception or practice. Our study suggests that the expected costs of bankruptcy may not be prohibitive enough to motivate consumers to limit their use of credit to an amount that is manageable.

If the expected costs of bankruptcy were sufficiently prohibitive, a consumer with serious financial problems would try less expensive alternatives to bankruptcy before filing. The petitioners in our sample had heard of and tried alternatives to bankruptcy. Only eight percent had not tried any of the alternatives to bankruptcy investigated in the study. However, the benefit of one of the most obvious alternatives to bankruptcy, credit counseling, may not be well known. For example, consumers can go to credit counseling to halt the collection activities of creditors. More than half of the petitioners had heard of credit counseling but only twenty percent had tried it.

One could argue that the financial problems of those consumers who appear in bankruptcy court may be too severe to be solved by counseling and many of the respondents in our study expressed this opinion. However, 18 percent of the sample had nonmortgage debts that were less than 50 percent of annual before-tax income which is about the average for consumers who do go to credit counseling. Presumably these consumers chose bankruptcy over credit counseling because the expected costs were less, holding benefits constant.

## III. Effect of 1978 Bankruptcy Reform Act on Costs of Bankruptcy

### A. Property Exemptions

One of the purposes of our study was to analyze the facets of the new bankruptcy law that may actually encourage the exercise of the option to take personal bankruptcy. One of the provisions of the bankruptcy law that the study was designed to analyze was the level of exempted assets. Consumers are allowed to retain a specified dollar value of certain assets in order to make a fresh start after bankruptcy. The amount of exempted assets allowed varies across states. We found that in those states with high exemptions, a significantly greater percentage of the sample fell in the highest income and asset category relative to the sample in the low exemption states. The implication is that the specification of the amount of assets that will be exempted in a straight bankruptcy serves as an admission threshold. Consumers with assets that exceed the amount that is exempted have less incentive to take bankruptcy, holding other things constant, than consumers who have all assets exempted in bankruptcy. Thus, the higher the threshold, the more attractive bankruptcy is to high-income consumers with considerable household and personal assets.

### B. Stay on Collection Activity

Another facet of the law that may make bankruptcy attractive to consumers is the provision requiring the immediate cessation of collection activities. Almost 30 percent of the sample indicated that one of the reasons they filed bankruptcy was because "creditors tried to collect." Forty percent of the sample indicated that they filed to avoid paying a particular creditor. Those petitioners who could have repaid 75 percent or more of their debts were significantly more likely to cite that response than those petitioners who could have repaid less than 25 percent of their nonmortgage debts in 36 months. The implication is that some consumers taking bankruptcy are using the bankruptcy system to evade the collection efforts of creditors and avoid pay affordable debts. Limitation of collection activity after the petition is filed may have been one of the more significant features in terms of the effect of the law on the perceived benefits of personal bankruptcy.

This feature of the bankruptcy law has serious and far-reaching ramifications on the credit markets as they exist today. Credit, especially unsecured credit, is extended on the faith that the creditworthy consumers understands that he or she has a legally binding obligation to repay the full amount of the loan. By providing a legal method to uncouple the legally binding credit contract between the lender and borrower, the current bankruptcy law could be expected to increase the risk and therefore the cost of all unsecured credit.

## IV. The Market's Response to the Bankruptcy Act

Changes in the ways that the market for consumer credit operates have already been made to reduce the expected benefits to consumers of taking bankruptcy as they are provided under the current law. Creditors who previously extended unsecured cash credit have drastically reduced the level of such activity. Secured credit such as second mortgage loans has been substituted for unsecured cash loans. Consumers with secured loans gain less from bankruptcy than consumers with unsecured loans, holding other things constant.

Creditors are being counseled to be more aggressive in challenging the documents of a bankruptcy case and to be more energetic in exercising the rights that they have with the existing law--an activity that will make bankruptcy more expensive for the consumer. In our sample we found that only 21 percent of petitioners had exemptions that protected all available assets. Thus, 79 percent of petitioners could expect to lose some assets by taking bankruptcy. A petitioner who anticipated a loss of assets would still have an incentive to take bankruptcy if the reduction in liabilities was greater than the expected loss of assets. However, we found that almost 13 percent of the sample had unsecured liabilities that were less than nonexempt assets. By taking bankruptcy, these petitioners realized no gain in wealth and actually suffered a reduction in wealth after lawyers' fees and loss of access to credit markets was accounted for.

Why would these consumers have declared bankruptcy? One hypothesis would be that creditors were not expected to exercise their rights to take nonexempt property to staisfy their claims or were not allowed to.

If that is the case, all petitioners realized a greater increase in wealth than shown in our analysis. If creditors do not insist on the enforcement of their rights to nonexempt assets, petitioners in bankruptcy basically have a larger amount of assets exempted than specified in the statute. This would make bankruptcy attractive for all consumers. Some creditors have made significant attacks on the problem of personal bankruptcy by demanding that closer attention be paid to the quality of information provided on the petition and by exercising their rights to collateral when they hold secured loans and to nonexempt assets when they hold unsecured loans. As a result, some creditors have experienced a reduction both in losses and in the incidence of petitioners choosing straight bankruptcy over a reorganization plan.

Another effective way to attack the problem of personal bankruptcy is suggested by the statistics concerning the petitioners' use of credit counseling. A concerted effort on the part of credit grantors toward the provision of low-cost, easily accessible, competent credit counseling services may provide a significant percentage of consumers who would otherwise take bankruptcy with an effective alternative to bankruptcy.

Finally, creditors are rapidly incorporating information that is predictive of bankruptcy into credit scoring models. The effect of these efforts will be a reduction in the amount of credit provided to high-risk applicants and perhaps a reduction in their need for debt relief. Industry studies of bankruptcy have found that credit reports of accounts that terminated with a bankruptcy showed a large number of credit sources being used and an increase in the number of credit inquiries shortly before the account went bankrupt. This is consistent with our findings. Petitioners for bankruptcy used credit from a large number of sources. Much of the credit was unsecured and obtained from sellers of goods and services rather than financial institutions.

The results presented in this monograph suggest that those who are developing credit scoring systems to identify potential bankruptcy may be wise to consider the effect of the costs and benefits of bankruptcy on a credit applicant's incentive to take bankruptcy. To make such an assessment, one would need fairly complete information about the applicant's assets and liabilities to estimate the net worth of the credit applicant. Obviously consumers with few assets, and great quantities of unsecured debts have much to gain by declaring bankruptcy. Converesely, those with a great amount of assets relative to liabilities have little to gain by declaring bankruptcy. It may be less costly to require more and better information on the financial conditions of loan applicants for credit scoring purposes than to try to discover characteristics that suggest the deterioration in moral fiber or the ulterior motives of the credit applicant.

## V. Proposed Changes in Bankruptcy Legislation

One of the proposed changes in the bankruptcy law would restrict access to bankruptcy on the basis of the petitioners ability to repay debts out of anticipated income. Analysis presented in this monograph suggests that an admissions test to Chapter 7 would limit the use of Chapter 7 to those who are in the greatest need of relief from debts and have the least ability to repay their debts out of expected income. Those who would be denied Chapter 7, according to our data, had more education, higher income, and fewer dependents than those who would be admitted to Chapter 7. This may be a desirable outcome from a public policy point of view.

Other revisions in the laws relating to bankruptcy which would have a definite impact on the costs and benefits of bankruptcy should be considered. For example, a consumer may file for bankruptcy once every seven years, and keep a legally determined amount of assets required to make a fresh start. One might assume that individuals are entitled to exempt assets to make a fresh start because credit markets are closed to the consumer after bankruptcy. However, from our study, we know that that is not the case. Petitioners who had filed for bankruptcy before were able to obtain credit from many of the same sources as those petitioners who had not filed before. One would argue that : (a) consumers, like businesses, should not be entitled to exempted assets. Consumers still possess their human capital after bankruptcy and can borrow against it to buy the assets needed to start afresh; and (b) consumers should be allowed to petition for bankruptcy as often as they want. This may appear extreme at first glance but lenders would be more likely to limit the extension of credit to applicants who had filed for bankruptcy in the past if they knew that consumers could immediately file for bankruptcy again. In our sample, approximately ten percent of petitioners involved at least one repeater. Thus, this addition to the law would likely have a significant impact on the incidence of personal bankruptcy.

An alternative proposal for reducing the benefits of bankruptcy would be to reduce the value of assets exempted from bankruptcy. The high level of households and personal property that is exempted in many states enables consumers with great quantities of households' assets to file bankruptcy at a very low cost. One should question whether middle and upper income citizens really need this type of public assistance.

Personal bankruptcy is a fact of life. Whether it is an inalienable right was addressed in the first monograph of this series. How it is used, who uses it, its benefits and costs were examined in this monograph. Characteristics of the credit markets and problems with the implementation of the current law as well as specific provisions of the current law have been explored as factors contributing to the incidence of personal bankruptcy through their effect on the costs and benefits of bankruptcy. We provide these data with the hope that policy-makers and creditors can find the most cost-effective way to provide debt relief for those whose finances become truly unmanageable while maintaining the general integrity and enforceability of consumer credit contracts.

# APPENDIX A

## SELECTED BIBLIOGRAPHY

The references listed below have been selected from the computerized bibliography maintained on an on-going basis at the Credit Research Center. This represents only a partial listing of over 350 references concerning bankruptcy. The selection was based on the relevancy, currency, and apparent depth of the references. Obviously, there have been errors of inclusion and exclusion.

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# APPENDIX B

## PERSONAL INTERVIEW QUESTIONNAIRE

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033081
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## CREDIT STUDY

RESPONDENT'S NAME:______________________________

ADDRESS:______________________________

CITY/STATE:______________________________

DATE:__________ TIME STARTED:__________ TIME ENDED:__________

INTERVIEWER:______________ LENGTH:______________ (MINUTES)

Hello. My name is ______________ of Opinion Research Corporation in Princeton, New Jersey. We have been requested by the Credit Research Center at Purdue University to conduct a nationwide survey on the subject of personal bankruptcy. As part of this survey, we are talking to people who have filed for bankruptcy so that we might better understand their attitudes and opinions. We are conducting this study with the full approval of the Court in which your case (is being) (was) heard. I want to stress that this survey is completely confidential, and that your answers will not be identified with you by name in any way.

| | | |
|---|---|---|
| A. | Have you already had your hearing today or will you have it after this interview? | 1 ALREADY HAD HEARING<br>2 WILL HAVE HEARING AFTER INTERVIEW |

IDENTIFICATION NUMBERS

☐☐ DISTRICT ☐☐ LOCATION ☐☐☐☐☐ RESPONDENT'S PETITION #

JUDGE'S NAME:

______________________________ ☐

(HAND EXHIBIT 1)

1a. On this card we've listed several factors that may or may not have led you to consider bankruptcy. Would you please read each item on the list, and tell me the number next to every factor that was important in your decision.

| | IMPORTANT | MOST IMPORTANT |
|---|---|---|
| Personal Problems | | |
| Medical bills (doctors, hospitals) | 1 | 1 |
| Marital problems (divorce, separation, alimony, child support) | 2 | 2 |
| Natural disasters (such as floods, hurricanes) | 3 | 3 |
| Death in the family | 4 | 4 |
| Addiction or dependency (drugs, alcohol, gambling) | 5 | 5 |
| Employment Problems | | |
| Cutback in the number of hours worked | 6 | 6 |
| Laid off or fired from work | 7 | 7 |
| Your business failed | 8 | 8 |
| Business that employed you failed | 9 | 9 |
| Unable to work due to illness/accident | 10 | 10 |
| Lost second income | 11 | 11 |
| Credit/Financial Problems | | |
| Bought too much on credit | 12 | 12 |
| Credit was too easy to get | 13 | 13 |
| Unable to get creditors to extend loans/ agree to different payment schedule | 14 | 14 |
| Creditors tried to collect their money | 15 | 15 |
| Sued by creditors | 16 | 16 |
| Wages actually garnished | 17 | 17 |
| Some property repossessed | 18 | 18 |
| Cosigned on a loan that wasn't paid | 19 | 19 |
| Cost of living went up | 20 | 20 |
| OTHER(S) (SPECIFY): | | |
| ______________________________ | 21 | 21 |
| ______________________________ | 22 | 22 |
| | x y | x y |

1b. Were there any other factors that led you to consider filing for bankruptcy? (RECORD ABOVE.)

IF MORE THAN ONE REASON GIVEN IN Qs.1a-b, ASK:

2. Of all the factors that led you to consider bankruptcy, which one or two were most important to you?

--3

ASK QUESTION 3 FOR ITEM "a." THEN ASK QUESTIONS 4 AND 5. THEN REPEAT QUESTIONS 3 AND 4/5 FOR EACH OF THE OTHER ("b," "c," "d") ITEMS.

3. Before you filed for bankruptcy, had you heard about (READ ITEM)?

IF "YES," ON Q. 3, ASK:

4. Did you try _______________ before you filed for bankruptcy?

IF "NO," ON Q. 4, ASK:

5. Why didn't you try ____________________?

| | HEARD OF | | TRIED | | WHY NOT |
|---|---|---|---|---|---|
| | YES | NO | YES | NO | |
| a. Credit counseling, where a counseler assists you in cutting back expenses and arranging partial payments | 1<br>x | 2<br>y | 1<br>x | 2<br>y | ________ ☐<br>________<br>x y |
| b. Debt consolidation loans, where you take out one loan to pay off all of your creditors and make only one monthly payment | 1<br>x | 2<br>y | 1<br>x | 2<br>y | ________ ☐<br>________<br>x y |
| c. Selling assets, such as property and possessions, to pay debts | 1<br>x | 2<br>y | 1<br>x | 2<br>y | ________ ☐<br>________<br>x y |
| d. Arranging different payment schedules with some or all of your creditors | 1<br>x | 2<br>y | 1<br>x | 2<br>y | ________ ☐<br>________<br>x y |

6. Where did you get the idea to declare bankruptcy? Was it from someone in particular or was it something you read or heard about? (PROBE: From whom or where did you read/hear about it?)

1 READ ARTICLE OR BOOK
2 ADVERTISEMENT IN NEWSPAPER/MAGAZINE
3 ADVERTISEMENT ON RADIO/TELEVISION
4 LAWYER OR LEGAL AID SERVICE
5 FRIEND/RELATIVE/COWORKER
6 CREDIT COUNSELING SERVICE
7 EMPLOYER
8 OWN IDEA/GENERAL KNOWLEDGE/JUST KNEW
9 OTHER (SPECIFY): __________________________
x y

7. Did you use a lawyer to help you file for bankruptcy?

1 YES
2 NO
x y → SKIP TO Q. 9

IF USED A LAWYER ("1" ON Q. 7), ASK:

8. How did you select your lawyer?

1 HE IS FAMILY LAWYER/USED HIM BEFORE
2 REFERRED BY ANOTHER LAWYER
3 ADVERTISEMENT
4 RECOMMENDED BY FRIEND/RELATIVE/COWORKER
5 FROM THE PHONE BOOK
6 OTHER (SPECIFY): ____________________
____________________
____________________
x y

9. Instead of the process you are using, there is an alternative legal process. Under that process you could have repaid all or some of your debts over a period of a few years, while still being protected from your creditors. When you were thinking about filing for bankruptcy, did you hear about this process?

1 YES
2 NO
x y → SKIP TO Q. 12

IF "YES" ("1" ON Q. 9), ASK:

10. What was this process called?

1 CHAPTER 13
2 OTHER (SPECIFY): ____________________
3 DON'T KNOW ____________________
x y

11. Why did you decide not to use this process? (DO NOT READ LIST. PROBE: Were there any other reasons?)

1 ATTORNEY ADVISED AGAINST IT
2 SPOUSE/FRIENDS ADVISED AGAINST IT
3 NOT ENOUGH INCOME/DEBTS TOO HIGH/WOULD HAVE TAKEN TOO LONG
4 TO AVOID PAYING CERTAIN CREDITORS
5 NO PARTICULAR REASON
6 OTHER (SPECIFY): ____________________
____________________
x y

(HAND EXHIBIT 2)

**12.** Here is a list of actions which creditors might take against someone who has not met their debt obligation. Would you please read the list and tell me the number of every action taken against you by any of your creditors.

| | CREDITORS DID | IMPORTANT |
|---|---|---|
| Threaten to repossess your personal property | 1 | 1 |
| Actually repossess your personal property | 2 | 2 |
| Seek to collect an unpaid balance after having repossessed some property | 3 | 3 |
| Threaten to foreclose on your home | 4 | 4 |
| Actually foreclose on your home | 5 | 5 |
| Threaten to garnish your wages | 6 | 6 |
| Actually garnish your wages | 7 | 7 |
| Telephone you frequently at home or work | 8 | 8 |
| Come to see you at home or work | 9 | 9 |
| Send you threatening letters | 10 | 10 |
| Contact a cosigner on a loan | 11 | 11 |
| Contact your employer | 12 | 12 |
| Contact a relative | 13 | 13 |
| OTHER (SPECIFY): ______________________ | 14 | 14 |
| NO ACTIONS TAKEN/NONE IMPORTANT | 15 | 15 |
| | x y | x y |

IF "YES" TO ANY STATEMENT ABOVE ("1" THRU "12"), ASK:

13. Which of these actions by your creditors were important in your decision to declare bankruptcy?

14a. In talking with other people who have declared bankruptcy we have found some who told us that one of the reasons they declared bankruptcy was not so much to cancel all their debts as it was to avoid one or more specific creditors. Would you say that this situation applies to you?

1 YES
2 NO → SKIP TO Q. 15
x y

IF "YES," ASK:

14b. Which creditors didn't you want to pay?
(DO NOT READ LIST. CIRCLE ALL THAT APPLY.)

1 BANK
2 SAVINGS & LOAN/MORTGAGE CO.
3 CREDIT UNION
4 FINANCE OR LOAN COMPANY
5 RETAILER/DEALER/CONTRACTOR
6 FRIEND/RELATIVE/COWORKER
7 DOCTOR/HOSPITAL
8 OTHER (SPECIFY): ______________________
______________________
x y

14c. What is the total amount that you owe this (those) creditor(s)? (IF DON'T KNOW EXACT AMOUNT, ASK FOR BEST ESTIMATE.)

$ ______________________
0 DON'T KNOW
x y

15. In the six months or so before you filed for bankruptcy, did you make any of the following purchases on credit? (READ LIST)

1 House or mobile home
2 Car or
3 Recreational vehicle or motorcycle
4 Home appliance or furniture costing over $200 per item
5 Jewelry, watch or fur costing over $200 per item
6 Vacation airfare, lodging or meals
7 Investment land or property
8 School tuition
9 NONE OF THESE
x y

15a. Did you use over $200 in credit either to get a cash loan or to make other purchases during the past six months? (IF "YES," ASK: What was it for?)

1 YES (SPECIFY): ______________________
______________________
2 NO
x y

(HAND EXHIBIT 3)

16. Which of the assets on the list do you plan to keep through provisions of the law, that is, exemptions, that permit you to keep items up to some dollar value? Just read me the numbers, please.

| | Exemptions | Reaffirmation |
|---|---|---|
| Financial assets | 1 | 1 |
| House or mobile home | 2 | 2 |
| Car | 3 | 3 |
| Truck | 4 | 4 |
| Recreational vehicle or motorcycle | 5 | 5 |
| Furniture or appliances | 6 | 6 |
| Jewelry, watch or furs | 7 | 7 |
| Clothing | 8 | 8 |
| Land or investment property | 9 | 9 |
| Any others? (SPECIFY): __________<br>______________________ | 10 | 10 |
| NONE | 11 | 11 |
| DON'T KNOW | 12 | 12 |
| | x y | x y |

17. And which do you plan to keep by agreeing to make payments after bankruptcy is final, sometimes called reaffirmation of the debt?

18. Are there any other creditors you plan to repay? (IF "YES, ASK: Which type of creditors?)

1 NO/NONE
2 BANK
3 SAVINGS & LOAN/MORTGAGE CO.
4 CREDIT UNION
5 FINANCE OR LOAN CO.
6 RETAILER/DEALER/CONTRACTOR
7 RELATIVE/FRIEND/COWORKER
8 DOCTOR/HOSPITAL
9 OTHER (SPECIFY): __________
______________________
x y

19. Which of the assets on this list do you expect to lose by filing for bankruptcy? Just read me the numbers please.

1 Financial assets

2 House or mobile home
3 Car
4 Truck
5 Recreational vehicle or motorcycle
6 Furniture or appliances
7 Jewelry, watch or furs

8 Clothing
9 Land or investment property
10 Any others? (SPECIFY): __________

11 NONE
12 DON'T KNOW
x y

IF FINANCIAL ASSETS LOST ("1" ON Q. 19),

20. Now, just think about the financial assests you expect to lose, that is, any bank accounts, stocks, bonds, or other financial investments. About how much money do you estimate you will lose? (IF NOT SURE, ASK FOR BEST ESTIMATE.)

$__________
0 DON'T KNOW
x y

IF ANY TYPE OF ASSETS LOST OTHER THAN FINANCIAL ("2-10" ON Q. 19), ASK:

21. Now, think just about personal property you expect to lose, that is, such things as (NAME ITEMS 2-10 CIRCLED in Q. 19). About how much do you think you could get for these goods if you sold them, rather than lost them through bankruptcy? (IF NOT SURE, ASK FOR BEST ESTIMATE.)

$__________
0 DON'T KNOW
x y

22. Compared to your credit situation before you filed for bankruptcy, do you think it will be more difficult or less difficult for you to get credit in the future from each of the following types of creditors?

| | MORE DIFFICULT | LESS DIFFICULT | NO CHANGE/ SAME AS BEFORE | DON'T KNOW |
|---|---|---|---|---|
| Bank | 1 | 2 | 3 | 4 |
| Savings & Loan or Mortgage Company | 1 | 2 | 3 | 4 |
| Credit Union | 1 | 2 | 3 | 4 |
| Finance or Loan Company | 1 | 2 | 3 | 4 |
| Retailer, Dealer, or Contractor | 1 | 2 | 3 | 4 |
| Friends, Family, or Coworkers | 1 | 2 | 3 | 4 |
| Doctor or Hospital | 1 | 2 | 3 | 4 |
| Other (Specify): __________ | 1 | 2 | 3 | 4 |
| __________ | 1 | 2 | 3 | 4 |

23. How did you learn about getting credit in the future? Who or what was your source of information?

1 READ ARTICLE OR BOOK
2 ADVERTISEMENT IN NEWSPAPER/MAGAZINE
3 ADVERTISEMENT ON RADIO/TELEVISION
4 LAWYER OR LEGAL AID SERVICE
5 FRIEND/RELATIVE/COWORKER

6 CREDIT COUNSELING SERVICE
7 OWN IDEA/GENERAL KNOWLEDGE/JUST KNEW
8 OTHER (SPECIFY): __________
x y

24. As you probably know, there are credit bureaus which keep track of people's credit experience. Do you think their credit report will show a record of your bankruptcy?

1 YES
2 NO
3 DON'T KNOW → SKIP TO Q. 26
x y

IF YES ("1" ON Q. 24), ASK:

25. For how many years will a record of your bankruptcy be on your credit record?

# ______________ YEARS
0 DON'T KNOW
x y

26. Do you know whether or not it would be legal for you to ever file for bankruptcy again?

1 YES
2 NO
3 DON'T KNOW → SKIP TO Q. 29
x y

IF YES ("1" ON Q. 26), ASK:

27. How many years from now could you file for bankruptcy again?

# ______________ YEARS
0 DON'T KNOW
x y

28. Would you ever again consider bankruptcy as a solution to your financial problems?

1 YES
2 NO
3 DON'T EXPECT ANY MORE PROBLEMS
4 DON'T INTEND TO LET THIS HAPPEN AGAIN
x y

(HAND EXHIBIT 4)

29. Which number in the first category on this card best describes your current marital status?

1 MARRIED
2 SEPARATED
3 DIVORCED
4 LIVING AS MARRIED
5 SINGLE-NEVER MARRIED
6 WIDOWED
x y

→ SKIP TO Q. 32

IF "1" OR "2" ON Q. 29, ASK:

30. Did you file for bankruptcy for yourself individually, or did you file jointly with your spouse?

1 INDIVIDUALLY
2 JOINTLY → SKIP TO Q. 32
x y

IF FILED "INDIVIDUALLY," ASK:

31a. Did your spouse also file for bankruptcy on (his)(her) own?

1 YES
2 NO → SKIP TO Q. 32
x y

IF "YES," ASK:

31b. Why did (he)(she) file for bankruptcy separately rather than ~~with you~~ in a joint petition?

☐
x y

31c. When and where did (he)(she) file for bankruptcy? (IF DON'T KNOW EXACT DATE, PROBE FOR YEAR AND APPROXIMATE MONTH)

DATE:__________ MONTH:__________ YEAR:__________

CITY:__________ STATE:__________

0 DON'T KNOW x y

32. Have you (or your [former] spouse) ever filed for bankruptcy before? (PROBE: Was it you, your spouse, or both of you jointly?)

1 NEVER FILED BEFORE
2 RESPONDENT FILED INDIVIDUALLY
3 SPOUSE FILED INDIVIDUALLY
4 FILED JOINTLY
5 RESPONDENT FILED JOINTLY WITH FORMER SPOUSE
6 SPOUSE FILED JOINTLY WITH FORMER SPOUSE
x y

IF "MARRIED" OR "SEPARTED" ("1" OR "2" ON Q. 29), ASK QUESTIONS 33-38 FOR BOTH HUSBAND AND WIFE. ALL OTHERS, ASK EACH QUESTION JUST FOR RESPONDENT. RECORD RESPONSES BY SEX.

(HAND EXHIBIT 4)

33. Which number in the middle category on this card contains your (your spouse's) age? Just read me the number, please.

| | MALE | FEMALE |
|---|---|---|
| Under 25 | 1 | 1 |
| 25-34 | 2 | 2 |
| 35-44 | 3 | 3 |
| 45-54 | 4 | 4 |
| 65 or older | 5 | 5 |
| | x y | x y |

34. And which number in the last category of this card describes the level of schooling that you (your spouse) completed?

| | MALE | FEMALE |
|---|---|---|
| Did not finish high school | 1 | 1 |
| High school graduate | 2 | 2 |
| Training or vocational school | 3 | 3 |
| Attended college courses | 4 | 4 |
| College graduate | 5 | 5 |
| Advanced college degree | 6 | 6 |
| | x y | x y |

35. Are you (Is your spouse) now employed, either full- or part-time?

| | MALE | FEMALE |
|---|---|---|
| Employed Full-Time | 1 | 1 |
| Employed Part-Time | 2 | 2 |
| Not Employed | 3 | 3 |
| | x y | x y |

IF RESPONDENT (OR SPOUSE) EMPLOYED, ASK:

35a. What type of work do you (does your spouse) do?

MALE: ______________________________ x y ☐

FEMALE: ______________________________ x y ☐

35b. Do you (Does your spouse) have a second job?

| | | | |
|---|---|---|---|
| MALE: | 1 YES | 2 NO | x y |
| FEMALE: | 1 YES | 2 NO | x y |

IF RESPONDENT (OR SPOUSE) NOT EMPLOYED, ASK:

(HAND EXHIBIT 5)

36. Which of the reasons listed on this card describes why you aren't (your spouse isn't) working? Just read me the number.

| | MALE | FEMALE |
|---|---|---|
| Student | 1 | 1 |
| Retired | 2 | 2 |
| Permanently disabled | 3 | 3 |
| Homemaker/care of children | 4 | 4 |
| Laid off/unable to find work | 5 | 5 |
| On strike | 6 | 6 |
| On sick leave | 7 | 7 |
| My business failed | 8 | 8 |
| Employer's business failed | 9 | 9 |
| OTHER REASON (SPECIFY): ______________________ ______________________ | 0 | 0 |
| | x y | x y |

37. How many months out of the past 12 have you (has your spouse) been employed, either full- or part-time?

| | MALE | FEMALE |
|---|---|---|
| # OF MONTHS: | ____ | ____ |
| | x y | x y |

38. Are you (Is your spouse) a member of a credit union?

| | MALE | FEMALE |
|---|---|---|
| YES | 1 | 1 |
| NO | 2 | 2 |
| | x y | x y |

39. How many people, including yourself and any others, are dependent on you for their principal means of support? This is the number of exemptions you report on your Federal income tax form.

# OF DEPENDENTS: ______________ x y

IF MORE THAN JUST RESPONDENT, ASK:

39a. Which of the following are dependent on you for their principal means of support?

1 Spouse
2 Children under 6 years of age (Specify how many:__________)
3 Children age 6-12 (Specify how many:__________)
4 Children age 13-17 (Specify how many:__________)
5 Children over age 17 (Specify how many:__________)
6 Parent (Specify how many:__________)
7 Other (Specify relationship__________and number:__________)
x y

40. Do you own or rent the dwelling in which you live?

1 OWN → SKIP TO Q. 42
2 RENT
3 NEITHER (LIVE WITH PARENT/ OTHER RENT-FREE) → SKIP TO Q. 43

IF "RENT," ASK:

41. How much do you pay in rent per month?

$ ________
x y

41a. Does your monthly rent include some or all of your utilities, that is, electricity, gas, oil, water, and telephone?

1 ALL UTILITIES INCLUDED → SKIP TO Q. 43
2 SOME UTILITIES INCLUDED
3 NO UTILITIES INCLUDED
x y

IF "SOME/NO UTILITIES INCLUDED", ASK:

41b. Over and above what is included in your rent payment, about how much do you pay directly for utilities per month? (IF NOT SURE, ASK FOR BEST ESTIMATE. IF CAN'T SPECIFY PER MONTH, ASK FOR BEST ESTIMATE OF TOTAL COST FOR LAST YEAR.)

$ ________ PER MONTH
OR
$ ________ LAST YEAR

0 DON'T KNOW
x y

→ SKIP TO Q. 43

IF "OWN" (#1" ON Q. 40), ASK:

42. What is your total monthly mortgage payment? (IF NOT SURE, ASK FOR BEST ESTIMATE)

$ ________
x y

42a. Does your monthly mortgage payment include your . . .?

| | INCLUDE YES | INCLUDE NO | | DON'T KNOW | | |
|---|---|---|---|---|---|---|
| a. Property tax | 1 | 2 | $ ________ PER YEAR | 0 | x | y |
| b. Homeowner's insurance | 1 | 2 | $ ________ PER YEAR | 0 | x | y |
| c. All utilities, that is, electricity, gas, oil, water, & telephone | 1 | 2 | $ ________ PER MONTH OR<br>$ ________ LAST YEAR | 0 | x | y |

FOR EACH ITEM NOT INCLUDED IN MORTGAGE, ASK:

42b. About how much do you pay . . .?

(a) Per year for property tax?
(b) Per year for homeowner's insurance?
(c) Per month for any utilities not included in your mortgage? (IF NOT SURE, ASK FOR BEST ESTIMATE. IF CAN'T GIVE MONTHLY COST, ASK FOR BEST ESTIMATE OF TOTAL COST FOR LAST YEAR)

43. Which, if any, of the following expenses do you usually have each month?

| MONTHLY EXPENSES | | AVERAGE MONTHLY PAYMENT | DON'T KNOW | | |
|---|---|---|---|---|---|
| Alimony | 1 | $ | 0 | x | y |
| Child support | 2 | $ | 0 | x | y |
| Child care because you (or your spouse) work | 3 | $ | 0 | x | y |
| Regular treatment of a long-term or chronic ailment | 4 | $ | 0 | x | y |
| Life or medical insurance | 5 | $ | 0 | x | y |
| Any other regular monthly payments (SPECIFY): | | | 0 | x | y |
| ____________ | 6 | $ | 0 | x | y |
| ____________ | 7 | $ | 0 | x | y |
| ____________ | 8 | $ | 0 | x | y |
| NONE | 9→SKIP TO Q. 45a | | | | |

FOR EACH MONTHLY EXPENSE, ASK:

44. What is your average monthly payment for ______________?

45a. Have you received any food stamps in the past month?

1 YES

2 NO →SKIP TO Q. 46

x y

IF "YES", ASK:

45b. What was the total value of the food stamps you received last month?

$____________

0 DON'T KNOW

x y

46. How much was your family's total income last month from nontaxable sources, such as social security, child support payments, unemployment or workmen's compensation, and welfare? (IF RESPONDENT IS NOT SURE, ASK FOR BEST ESTIMATE.)

$____________

0 NONE

9 DON'T KNOW

x y

47. And, how much was your total family income before taxes from all taxable sources last month? (IF RESPONDENT IS NOT SURE, ASK FOR BEST ESTIMATE.)

$____________

0 NONE

9 DON'T KNOW

x y

48. By December of this year, how likely is it that your total monthly income from all sources will be higher or lower than it was last month? Would you say that it will definitely be higher, probably be higher, probably be lower, definitely be lower, or will it be about the same?

1 DEFINITELY HIGHER
2 PROBABLY HIGHER
3 PROBABLY LOWER
4 DEFINITELY LOWER
5 ABOUT THE SAME
6 DON'T KNOW
x y

IF "HIGHER" OR "LOWER" ON Q. 48, ASK:

49. Do you expect that (increase) (decrease) will be 10% or less or will it be over 10%?

1 10% OR LESS
2 OVER 10%
3 DON'T KNOW
x y

INTERVIEWER: HAND THE CREDIT REPORT RELEASE FORM TO RESPONDENT(S) AND ASK HIM/HER/THEM TO READ IT AND THEN TO FILL IN THE REQUESTED INFORMATION AND SIGN HIS/HER/THEIR NAME(S).

Thank you very much for your time and cooperation.

RECORD THE FOLLOWING:

RESPONDENT'S SEX: 1 MALE 2 FEMALE

RESPONDENT'S RACE: 1 WHITE 2 BLACK 3 HISPANIC 4 OTHER

WILL RELEASE CREDIT REPORT: 1 YES 2 NO x y

ATTORNEY ATTENDED THE INTERVIEW: 1 YES 2 NO

INTERVIEWER: ON A SCALE OF "1" to "5", HOW WOULD YOU DESCRIBE HOW OPEN AND COOPERATIVE THIS RESPONDENT WAS DURING THE INTERVIEW?

| | | | | | | |
|---|---|---|---|---|---|---|
| VERY OPEN/<br>VERY COOPERATIVE | 1 | 2 | 3 | 4 | 5 | NOT AT ALL OPEN/<br>VERY UNCOOPERATIVE |

INTERVIEWER: ATTACH RESPONDENT'S CREDIT REPORT RELEASE FORM AND A COPY OF HIS/HER BANKRUPTCY PETITION (WHICH YOU MUST OBTAIN FROM THE CLERK OR XEROX) TO THIS QUESTIONNAIRE.

## EXHIBIT 1

### Personal Problems

1 Medical bills (doctors, hospitals)
2 Marital problems (divorce, separation, alimony, child support)
3 Natural disasters (such as floods, hurricanes)
4 Death in the family
5 Addiction or dependency (drugs, alcohol, gambling)

### Employment Problems

6 Cutback in the number of hours worked
7 Laid off or fired from work
8 Your business failed
9 Business that employed you failed
10 Unable to work due to illness/accident
11 Lost second income

### Credit/Financial Problems

12 Bought too much on credit
13 Credit was too easy to get
14 Unable to get creditors to extend loans/ agree to different payment schedule
15 Creditors tried to collect their money
16 Sued by creditors
17 Wages actually garnished
18 Some property repossessed
19 Cosigned on a loan that wasn't paid
20 Cost of living went up
21 Anything else? (PLEASE SPECIFY)

# EXHIBIT 2

1 Threaten to repossess your personal property

2 Actually repossess your personal property

3 Seek to collect an unpaid balance *after* having repossessed some property

4 Threaten to foreclose on your home

5 Actually foreclose on your home

6 Threaten to garnish your wages

7 Actually garnish your wages

8 Telephone you frequently at home or work

9 Come to see you at home or work

10 Send you threatening letters

11 Contact a cosigner on a loan

12 Contact your employer

13 Contact a relative

14 Anything else? (PLEASE SPECIFY)

## EXHIBIT 3

1 Financial assets (bank accounts, stocks, bonds, CD's)
2 House or mobile home
3 Car
4 Truck
5 Recreational vehicle or motorcycle
6 Furniture or appliances
7 Jewelry, watch, or furs
8 Clothing
9 Land or investment property
10 Any Others? (PLEASE SPECIFY)

## EXHIBIT 4

| | | |
|---|---|---|
| MARITAL STATUS | 1 | MARRIED |
| | 2 | SEPARATED |
| | 3 | DIVORCED |
| | 4 | LIVING AS MARRIED |
| | 5 | SINGLE-NEVER MARRIED |
| | 6 | WIDOWED |
| AGE | 1 | Under 25 |
| | 2 | 25-34 |
| | 3 | 35-44 |
| | 4 | 45-54 |
| | 5 | 55-64 |
| | 6 | 65 or older |
| EDUCATION | 1 | Did not finish high school |
| | 2 | High school graduate |
| | 3 | Training or vocational school |
| | 4 | Attended college courses |
| | 5 | College graduate |
| | 6 | Advanced college degree |

EXHIBIT 5

1 Student
2 Retired
3 Permanently disabled
4 Homemaker/care of children
5 Laid off/unable to find work
6 On strike
7 On sick leave
8 My business failed
9 Employer's business failed
10 OTHER (PLEASE SPECIFY)

## AUTHORIZATION FOR CREDIT REPORT

I/We, the undersigned, have voluntarily participated in an interview as part of a study of personal bankruptcy conducted by the Credit Research Center of Purdue University.

By signing this paper, I/we authorize the credit reporting agency (credit bureau) in my/our area to provide the Credit Research Center with my/our credit report(s) applicable to the time of my/our filing for bankruptcy.

This authorization is for the sole purpose of the bankruptcy study. My/Our understanding is that our name and address will be removed from the credit report and any data used in the study will be treated anonymously.

PLEASE PRINT:

YOUR FULL NAME: ________________________________________

YOUR SOCIAL SECURITY NUMBER: ______________________________

IF MARRIED:

YOUR SPOUSE'S NAME: _____________________________________

YOUR SPOUSE'S SOCIAL SECURITY NUMBER: ________________________

ADDRESS: ______________________________________________

CITY: ____________________ STATE: ___________ ZIP CODE: ______

IF YOU HAVE LIVED AT THE ABOVE ADDRESS LESS THAN ONE YEAR, PLEASE FILL IN YOUR FORMER ADDRESS:

FORMER ADDRESS: _________________________________________

CITY: ____________________ STATE: ___________ ZIP CODE: ______

PLEASE SIGN:

YOUR SIGNATURE: __________________________________________

SPOUSE'S SIGNATURE: ______________________________________

DATE: _________________________________________________

# APPENDIX C

## DATA RECORDED FROM CHAPTER 7 PETITION

33852

## CREDIT STUDY

## PETITION DATA SHEET

1 Petition Data of Debtor Interviewed Before Hearing
2 Petition Data of Debtor Interviewed After Hearing
→ Yellow Form

3 Petition Data of Debtor Who Refused Interview
→ Blue Form

### COVER SHEET(S)

1. Respondent's Petition # (use last 5 numbers): ___ ___ ___ ___ ___
(Also called bankruptcy, docket, file, proceeding, or case number)

2. Debtor (petitioner) is: 1 Individual 2 Husband/wife jointly

(Cover sheet may indicate "Individual" or "Joint" Petition or there will be boxes next to the words "individual" and "husband and wife as joint individuals" and the appropriate one will be checked to indicate an individual or joint petition)

3. Debtor's name and social security number (include both parties if joint petition):

Male: ______________________ Social Security #: ______________

Female: ______________________ Social Security #: ______________

4. Zip Code (of most recent address): ___ ___ ___ ___ ___ ___

5. Date filed (or executed on): ____/____/____
(Stamped or written in) Month Date Year

### STATEMENT PURSUANT TO RULE 219b OR DISCLOSURE OF COMPENSATION PAID OR PROMISED TO ATTORNEY

6. Legal services used: 1 Yes 2 No

(No "Rule 219b Statement" attached to petition implies no legal services used. Circle "2" and go on to #7.)

If Legal Services Used:

a. Total fee (paid and promised/due): $ ______________ 0 NR

b. Attorney's Name: ______________________

Address:

______________ ______________

STATEMENT OF FINANCIAL AFFAIRS

7. Specify which form used (heading across top of page or top right corner)

1 Statement of Financial Affairs for Debtor Not Engaged in Business → SKIP TO #12

2 Statement of Financial Affairs For Debtor Engaged in Business → GO TO #8

Debtor Engaged In Business ("2" circled on #7)

8. Prior bankruptcy
(probably item #7)
1 One or more prior bankruptcies listed
2 No other bankruptcies listed

9. Suits, executions, and attachments
(probably item 12)
Property attached, garnished, or seized (probably "c" in this section) 1 Yes 2 No 3 NR

10. Transfer of property
(probably item 14)
(1) Made one or more unusual gifts in year prior to bankruptcy (probably "a" in this section) 1 Yes 2 No 3 NR
(2) Made other transfer(s) (probably "b" in this section) 1 Yes 2 No 3 NR

11. Repossessions and returns
(probably item #13)
Any property returned to/repossessed by seller during year preceding bankruptcy 1 Yes 2 No 3 NR

→ SKIP TO #17

Debtor Not Engaged In Business ("1" Circled On #7)

12. Occupation and Income
(Probably item #2)

| | | Total | RECORD HERE ALSO IF JOINT PETITION AND AMOUNTS SPECIFIED FOR BOTH PARTIES | |
|---|---|---|---|---|
| | | | Male | Female |
| (1) Income from trade and profession<br>(probably "d" in this Section) | | | | |
| | 1980 | \$______<br>0 None X NR | \$______<br>0 None X NR | \$______<br>0 None X NR |
| | 1979 | \$______<br>0 None X NR | \$______<br>0 None X NR | \$______<br>0 None X NR |
| (2) Income from other sources<br>(probably "e" in this Section) | | | | |
| | 1980 | \$______<br>0 None X NR | \$______<br>0 None X NR | \$______<br>0 None X NR |
| | 1979 | \$______<br>0 None X NR | \$______<br>0 None X NR | \$______<br>0 None X NR |

13. Prior bankruptcy
(probably item #7)
1 One or more prior bankruptcies listed
2 No other bankruptcies listed

14. Suits, executions, and attachments
(probably item #10)
Property attached, garnished, or seized
(probably "c" in this section)
1 Yes 2 No 3 NR

15. Transfer of property
(probably item #12)
(1) Made one or more unusual gifts in year prior to bankruptcy
(probably "a" in this section)
1 Yes 2 No 3 NR

(2) Made other transfer(s)
(probably "b" in this section)
1 Yes 2 No 3 NR

16. Repossessions and returns
(probably item #13)
Any property returned to/repossessed by seller during year prior to bankruptcy)
1 Yes 2 No 3 NR

→ GO ON TO #17

## SCHEDULE A-2 CREDITORS HOLDING SECURITY

(Schedule A-2 is sometimes listed as a separate section or page. If so, include the requested information for all items in this section. Add up the "Market Value" and the "Amount of Claim" of all items listed (if no "totals" are shown) and record each of these totals in the spaces below.

If Schedules A-2 and A-3 are listed together, include below only those items checked as "secured." Include the totals only for the secured items.)

17. Total market value of all (secured) items listed $__________

18. Total claims of all (secured) items listed $__________

19. FOR EACH ITEM/TYPE OF SECURITY LISTED IN SCHEDULE A-2, SPECIFY:

| | ITEM/TYPE OF SECURITY | WHEN INCURRED MONTH/YEAR | MARKET VALUE | AMOUNT OF CLAIM |
|---|---|---|---|---|
| 1 | House (1st/only mortgage)*<br>0 No house listed | ___/___<br>0 NR | $___<br>0 NR | $___<br>0 NR |
| 2 | Same house (2nd mortgage)<br>0 No second mortgage | ___<br>0 NR | $___<br>0 NR | $___<br>0 NR |

FOR ALL OTHER ITEMS LISTED IN SCHEDULE A-2, FILL IN GENERAL DESCRIPTION (E.G., CAR, BOAT, FURNITURE) IN THE SPACE BELOW AND COMPLETE THE REST OF THE INFORMATION:

| | | | | |
|---|---|---|---|---|
| 3 | ______ | ___/___<br>0 NR | $___<br>0 NR | $___<br>0 NR |
| 4 | ______ | ___/___<br>0 NR | $___<br>0 NR | $___<br>0 NR |
| 5 | ______ | ___/___<br>0 NR | $___<br>0 NR | $___<br>0 NR |
| 6 | ______ | ___/___<br>0 NR | $___<br>0 NR | $___<br>0 NR |
| 7 | ______ | ___/___<br>0 NR | $___<br>0 NR | $___<br>0 NR |
| 8 | ______ | ___/___<br>0 NR | $___<br>0 NR | $___<br>0 NR |
| 9 | ______ | ___/___<br>0 NR | $___<br>0 NR | $___<br>0 NR |

*If there is more than one mortgage (creditor and claim) on the same house and no distinction is made as to first or second mortgage, assume that the "first" mortgage is the older (earlier date on when incurred) one. If no dates are given, assume that the larger amount is the "first" mortgage.

#19 (Continued) Schedule A-2

| ITEM/TYPE OF SECURITY | WHEN INCURRED | MARKET VALUE | AMOUNT OF CLAIM |
|---|---|---|---|
| 10 | /<br>0 NR | $<br>0 NR | $<br>0 NR |
| 11 | /<br>0 NR | $<br>0 NR | $<br>0 NR |
| 12 | /<br>0 NR | $<br>0 NR | $<br>0 NR |
| 13 | /<br>0 NR | $<br>0 NR | $<br>0 NR |
| 14 | /<br>0 NR | $<br>0 NR | $<br>0 NR |
| 15 | /<br>0 NR | $<br>0 NR | $<br>0 NR |
| 16 | /<br>0 NR | $<br>0 NR | $<br>0 NR |
| 17 | /<br>0 NR | $<br>0 NR | $<br>0 NR |
| 18 | /<br>0 NR | $<br>0 NR | $<br>0 NR |
| 19 | /<br>0 NR | $<br>0 NR | $<br>0 NR |
| 20 | /<br>0 NR | $<br>0 NR | $<br>0 NR |
| 21 | /<br>0 NR | $<br>0 NR | $<br>0 NR |
| 22 | /<br>0 NR | $<br>0 NR | $<br>0 NR |
| 23 | /<br>0 NR | $<br>0 NR | $<br>0 NR |
| 24 | /<br>0 NR | $<br>0 NR | $<br>0 NR |
| 25 | /<br>0 NR | $<br>0 NR | $<br>0 NR |
| 26 | /<br>0 NR | $<br>0 NR | $<br>0 NR |

## SCHEDULE A-3 CREDITORS HAVING UNSECURED CLAIMS WITHOUT PRIORITY

(If Schedule A-3 is listed as a separate section or page, include the requested information for all items included in this section. Add up the "Amount of Claim" of all items listed (if no "total" is shown) and record the total in the space below. (Note: Page may be called "Listing of Creditors.")

If Schedule A-3 is listed with Schedule A-2, include below only those items checked as "unsecured." Include the total only for the unsecured items.

20. Total claims of all (unsecured) items listed $ ____________

CREDITOR CODES:

1 Bank
2 Savings & Loan or Mortgage Company
3 Credit Union
4 Finance or Loan Company
5 Retailer (Store)
6 Dealer or Contractor
7 Doctor or Hospital
8 Friend or Relative or Co-worker
9 Other/Not Sure of Type (SPECIFY NAME IN SPACE)

21. FOR EACH CREDITOR LISTED IN SCHEDULE A-3, CIRCLE APPROPRIATE CREDITOR CODE AND FILL IN AMOUNT OF CLAIM

| | CREDITOR CODE | AMOUNT OF CLAIM |
|---|---|---|
| #1 | 1 2 3 4 5 6 7 8 9 (SPECIFY BELOW)<br>____________ | $ ____________ |
| #2 | 1 2 3 4 5 6 7 8 9 (SPECIFY BELOW)<br>____________ | $ ____________ |
| #3 | 1 2 3 4 5 6 7 8 9 (SPECIFY BELOW)<br>____________ | $ ____________ |
| #4 | 1 2 3 4 5 6 7 8 9 (SPECIFY BELOW)<br>____________ | $ ____________ |
| #5 | 1 2 3 4 5 6 7 8 9 (SPECIFY BELOW)<br>____________ | $ ____________ |
| #6 | 1 2 3 4 5 6 7 8 9 (SPECIFY BELOW)<br>____________ | $ ____________ |
| #7 | 1 2 3 4 5 6 7 8 9 (SPECIFY BELOW)<br>____________ | $ ____________ |

#21 (Continued) Schedule A-3

| | CREDITOR CODE | AMOUNT OF CLAIM |
|---|---|---|
| #8 | 1 2 3 4 5 6 7 8 9 (SPECIFY BELOW)<br>________________ | $ ____________ |
| #9 | 1 2 3 4 5 6 7 8 9 (SPECIFY BELOW)<br>________________ | $ ____________ |
| #10 | 1 2 3 4 5 6 7 8 9 (SPECIFY BELOW)<br>________________ | $ ____________ |
| #11 | 1 2 3 4 5 6 7 8 9 (SPECIFY BELOW)<br>________________ | $ ____________ |
| #12 | 1 2 3 4 5 6 7 8 9 (SPECIFY BELOW)<br>________________ | $ ____________ |
| #13 | 1 2 3 4 5 6 7 8 9 (SPECIFY BELOW)<br>________________ | $ ____________ |
| #14 | 1 2 3 4 5 6 7 8 9 (SPECIFY BELOW)<br>________________ | $ ____________ |
| #15 | 1 2 3 4 5 6 7 8 9 (SPECIFY BELOW)<br>________________ | $ ____________ |
| #16 | 1 2 3 4 5 6 7 8 9 (SPECIFY BELOW)<br>________________ | $ ____________ |
| #17 | 1 2 3 4 5 6 7 8 9 (SPECIFY BELOW)<br>________________ | $ ____________ |
| #18 | 1 2 3 4 5 6 7 8 9 (SPECIFY BELOW)<br>________________ | $ ____________ |

SCHEDULE B-1 REAL PROPERTY

22. Market value of each house listed:

$ ________________ $ ________________ $ ________________

0 No house(s) listed

EXEMPTION ELECTION (Located Between Schedules B-3 and B-4)

23. The debtor(s) elects to . . . exempt(ions) pursuant to
(Circle item(s) checked)

1 Federal Exemption 11 U.S.C. 522  3 Both
2 State Exemption (laws of the State ________________)  4 NR

SCHEDULE B-4 PROPERTY CLAIMED AS EXEMPT

24. Value claimed exempt -- total  $ ________________

(If no total amount is shown, add up the value claimed exempt for each item listed in B-4)  0 NONE  X NR

SUMMARY OF DEBTS AND PROPERTY

25. A-2 Secured claims  $ ________________  0 NONE

26. A-3 Unsecured claims without priority  $ ________________  0 NONE

27. Schedule A Total  $ ________________  0 NONE

28. B-1 Real property (total value)  $ ________________  0 NONE

29. Schedule B Total  $ ________________  0 NONE

30. Does Schedule B Total include item listings for B-1, B-2, B-3 and B-4 or isn't the B-4 item included in (above) the Schedule B Total line?

1 B-4 Is included in total
2 B-4 Is not included

## PUBLICATIONS
## CREDIT RESEARCH CENTER

MONOGRAPH No. 1: An Empirical Analysis of Retail Revolving Credit
MONOGRAPH No. 2: Credit Policies and Store Locations in Arkansas Border Cities: Merchant Reactions to a Ten Percent Finance Charge Ceiling
MONOGRAPH No. 3: Research Topics in Mortgage Markets: Proceedings of a Seminar
MONOGRAPH No. 4: An Economic Report on Consumer Lending in Texas
MONOGRAPH No. 5: Mortgage Banking 1963 to 1972: A Financial Intermediary in Transition
MONOGRAPH No. 6: A Thesaurus of Terms in Mortgage and Consumer Credit
MONOGRAPH No. 7: A Bibliography of Consumer Financial Services and Regulation
MONOGRAPH No. 8: A Compilation of Federal and State Laws Regulating Consumer Financial Services
MONOGRAPH No. 10: The Impact of Regulation on the Provision of Consumer Financial Services by Depository Institutions: Research Backgrounds and Needs
MONOGRAPH No. 12: Cost/Benefit Analysis of Creditors' Remedies
MONOGRAPH No. 13: Consumer Perception of Credit Insurance on Retail Purchases
MONOGRAPH No. 14: An Economic Analysis of the "Due On Sale" Clause in the California Mortgage Market
MONOGRAPH No. 15: Credit Unions: CRC 1979 Creditors Survey
MONOGRAPH No. 16: Savings and Loan Associations: CRC 1979 Creditors Survey
MONOGRAPH No. 17: Commercial Banks: CRC 1979 Creditors Survey
MONOGRAPH No. 18: Consumer Finance Companies: CRC 1979 Creditors Survey
MONOGRAPH No. 19: Retailers: CRC 1979 Creditors Survey
MONOGRAPH No. 20: Sales Finance Companies: CRC 1979 Creditors Survey
MONOGRAPH No. 21: Consumer Financial Data Sources
MONOGRAPH No. 22: CRC 1979 Consumer Financial Survey
MONOGRAPH No. 23: Consumer Bankruptcy Study, Volume 1, Consumers' Right to Bankruptcy Origins and Effects
MONOGRAPH No. 24: Personal Bankruptcy: Causes, Costs and Benefits, Volume II
WORKING PAPER No. 1: The Use of Department Store Revolving Credit: Account Use Patterns, Customer Profitability, the Value of Revolving Credit, and the Probable Incidence of Credit Rationing
WORKING PAPER No. 2: EFTS and Consumer Credit (Revised)
WORKING PAPER No. 3: The Impact of General Credit Restraint on Consumer Instalment Credit Flows
WORKING PAPER No. 4: The Effect of Alternative Billing Methods Upon Retail Revolving Credit Yields
WORKING PAPER No. 5: Delinquency Rates on Consumer and Mortgage Debt: Their Determinants and Impact
WORKING PAPER No. 6: Determinants of Commercial Bank Automobile Loan Rates
WORKING PAPER No. 7: Personal Loan Cash Flows at Finance Companies
WORKING PAPER No. 8: Discrimination on the Basis of Sex Under the Equal Credit Opportunity Act
WORKING PAPER No. 9: Competition Between Banks and Finance Companies: A Cross Section Study of Personal Loan Debtors
WORKING PAPER No. 10: Regulatory Influences on Commercial Bank Personal Loan Rates
WORKING PAPER No. 11: Commercial Bank Consumer Loan Refinancings
WORKING PAPER No. 12: The Impact of Restricted Creditors' Remedies on Automobile Finance Companies in Wisconsin
WORKING PAPER No. 13: Changes in Finance Personal Loan Policies Following Enactment of the Wisconsin Consumer Act
WORKING PAPER No. 14: Creditor Remedy Restrictions and Interstate Differences in Personal Loan Rates and Availability: A Supplementary Analysis
WORKING PAPER No. 15: The Impact of Creditors' Remedies on Consumer Loan Charges
WORKING PAPER No. 16: Cost/Benefit Analysis of Minimum Charges on Revolving Credit Accounts
WORKING PAPER No. 17: Occupational and Employment Variations in Commercial Bank Consumer Credit-Risk
WORKING PAPER No. 18: Problems in Applying Discriminant Analysis in Credit Scoring Models
WORKING PAPER No. 19: Testing for Sex Discrimination in Commercial Bank Consumer Lending
WORKING PAPER No. 20: Banks' Lending Response to Restricted Creditor Remedies
WORKING PAPER No. 21: Bank and Retail Credit Card Yields Under Alternative Assessment Methods
WORKING PAPER No. 22: An Economic Analysis of Electronic Funds Transfer System: The Theory of Credit Markets
WORKING PAPER No. 24: The Community Re-investment Act of 1977: Its Legislative History and Its Impact on Applications for Changes in Structure Made by Depository Institutions to the Four Federal Financial Supervisory Agencies
WORKING PAPER No. 25: Junior Mortgage Financing and Other Borrowing Against Inflated Housing Equity
WORKING PAPER No. 26: Consumer Perceptions of Credit Bureaus
WORKING PAPER No. 27: Mobile Home Demand and Sources of Financing
WORKING PAPER No. 28: An Investigation of Sex Discrimination of Commercial Banks' Direct Consumer Lending
WORKING PAPER No. 29: The Transfer Implications of Consumer Credit Regulation
WORKING PAPER No. 30: Accelerating Inflation and the Distribution of Household Savings Incentives
WORKING PAPER No. 31: Rates of Return on GNMA Securities: the Cost of Mortgage Funds
WORKING PAPER No. 32: The Response of Commercial Banks to Rate Ceilings and Restrictions on Remedies on Consumer Credit Contracts
WORKING PAPER No. 33: Second Mortgage Survey, 1979
WORKING PAPER No. 34: Value Pricing of Bank Card Services
WORKING PAPER No. 35: Restrictive Effects of Rate Ceilings on Consumer Choice: The Massachusetts Experience
WORKING PAPER No. 36: Evidence of the Effect of Restrictive Loan Rate Ceilings on Prices of Consumer Financial Services
WORKING PAPER No. 37: Household Financial Behavior: Implications For Consumer Spending
WORKING PAPER No. 38: Effects of Consumer Loan Rate Ceilings on Competition Between Banks and Finance Companies
WORKING PAPER No. 39: 1980 Second Mortgage Survey
WORKING PAPER No. 40: Impact of a Ten Percent Usury Ceiling: Empirical Evidence
WORKING PAPER No. 41: Cost and Benefits of Restrictions on Creditor's Remedies
WORKING PAPER No. 42: Consumer Use of Mortgage Credit
WORKING PAPER No. 43: Second Mortgage Survey 1981
REPRINT No. 1: John J. McConnell, "Evaluation Model Can Maximize Single-Family Servicing Profits," *Mortgage Banker*, March 1975; and "Profit/Loss Evaluation Model Has Varied Applications," *Mortgage Banker*, May 1975 (Out-of-print)
REPRINT No. 2: Robert W. Johnson, "The Rationale For Acquisition of Finance Companies by Bank Holding Companies," *The Banking Law Journal*, April 1975 (Out-of-print)
REPRINT No. 3: William C. Dunkelberg and Robert H. Smiley, "Subsidies in the Use of Revolving Credit;" *Money, Credit, and Banking*, November 1975
REPRINT No. 4: Michael S. Long, "Credit Screening System Selection," *Journal of Financial and Quantitative Analysis*, June 1975 (Out-of-print)
REPRINT No. 5: John J. McConnell, "Valuation of a Mortgage Company's Servicing Portfolio," *Journal of Financial and Quantitative Analysis*, September 1976
REPRINT No. 6: Richard L. Peterson, "The Impact of General Credit Restraint of the Supply of Commercial Bank Consumer Instalment Credit;" *Money, Credit, and Banking*, November 1976
REPRINT No. 7: John J. McConnell, "Mortgage Company Bids on the GNMA Auction," *Journal of Bank Research*, winter 1977

(Continued on back cover)

REPRINT No. 8: Richard L. Peterson, "Factors Affecting the Growth of Bank Credit Card and Check Credit," *The Journal of Finance,* May 1977

REPRINT No. 9: John J. McConnell, "Price Distortions Induced by the Revenue Structure of Federally-Sponsored Mortgage Loan Programs," *Journal of Finance,* September 1977

REPRINT No. 10: James F. Smith, "The Equal Credit Opportunity Act of 1974: A Cost/Benefit Analysis," *The Journal of Finance,* May 1977

REPRINT No. 11: David S. Kidwell and Richard L. Peterson, "A Close Look at Credit Unions," *The Bankers Magazine,* January-February 1978

REPRINT No. 12: Robert W. Johnson, "Pricing of Bank Card Services," *The Journal of Retail Banking,* June 1979

REPRINT No. 13: Richard L. Peterson, "The Costs of Consumer Credit Regulation," *Issues in Bank Regulation,* Winter 1979

REPRINT No. 14: Robert W. Johnson, "Economic Effects of Graduated Rate Ceilings on Revolving Credit," *Journal of Retail Banking,* Vol. II, No. 1, March 1980.

REPRINT No. 15: Robert W. Johnson and A. Charlene Sullivan, "Segmentation of the Consumer Loan Market," *Journal of Retail Banking,* Vol. III, No. 3, September 1981.

REPRINT No. 16: Richard L. Peterson, "An Investigation of Sex Discrimination in Commercial Banks' Direct Consumer Lending," *The Bell Journal of Economics,* Vol. 12, No. 2, Autumn 1981.